

Liability for Executives in Russian
Companies with Limited Liability and
Russian Joint Stock Companies

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Introduction

1.1 Introductory remarks

After the collapse of the Soviet Union a new economic order was set up in Russia. At the same time a new world was revealed for private entrepreneurs and investors. However, this new world was not ready-made for Western investors. The collapse of the Soviet Union left a vacuum of appropriate legislation for dealing with a market economy. Being used to a command economy, learning to think in terms of “private property” was an enormous change to the Russian population, both in economic, as well as cultural and legal terms. The transition to a market economy necessitated comprehensive changes to the Russian legal system, so a series of new regulations were introduced. The models for these regulations were borrowed from other national jurisdictions with long traditions for market regulations, namely Western countries. When drafting the law of post-Soviet Russia, it has been extensively developed with foreign legal assistance, in particular the U.S and Germany.¹ On the one hand, this provided an opportunity for lawmakers to engage in the construction of new and outstanding legislation within different fields of law, without being constrained by local legal traditions (e.g. common law and civil law).² On the other hand, their lack of understanding of the law’s social environment in Russia, and the unfavorable market conditions that prevailed at that time, meant that they might also implement inappropriate legal solutions.³ Russia has been a sort of laboratory of comparative law reforms whose end is not yet in sight.⁴

Perfect legislation does not necessarily lead to a perfect society. It is essential that the law fit into the social and cultural “landscape” it is supposed to regulate, and to define the landscape in a transition

¹ P. 637, in Butler W E, *Russian Law*, in: Elgar Encyclopedia of Comparative Law, ed. Smits, J. S., Edward Elgar Publishing Limited, 2006 (hereinafter, Butler 2006).

² See for example Black S B, Kraakman R and Tarassova A S, *Guide to the Russian Law on Joint Stock Companies*, Kluwer Law International, 1998 (hereinafter, Black, Kraakman and Tarassova). The authors were actively involved in the construction of the Russian Act on Joint Stock Companies (see full reference in n 38), and they make note on how this Act was constructed as hybrid between mainly American and German law.

³ The word “law” is utilized in this thesis as the latin word “jus” (corresponding to the word “recht”, “droit” “derecho”, “rett” “право”), i.e. it does not designate formally adopted written legal acts, but the norms that emanate from them. For the sake of distinction, the author utilizes the word “act” or “legal act” when referring to written law (written legal acts formally adopted by bodies recognized in the Russian Constitution and by court decisions). In Russian, the word “закон” is applied for legal acts. Differently, see e.g. Alekseev, p. 461, footnote 1 (Alekseev S S, *Theory of Law*, in: Russian Legal Theory (Butler W. ed), Dartmouth Publishing Company Limited 1996, hereinafter Alekseev), is using the word “jus” as a translation of “право”, while “law” is used as a translation of “закон”.

⁴ Butler 2006, p. 635.

economy is not an easy task.⁵ As a consequence of the law-making processes of the 1990s, the number of legal reforms and amendments in Russia has been high ever since, with step-by-step adoptions to the law to adjust for gaps and meet the current needs of society. It would be inappropriate to say that a full-fledged Western business environment was created in Russia. Nonetheless, much has been done, and the extreme business environment of the 1990s, with its lawlessness and deterioration of civil society, are fortunately a covered distance.

The Russia of today is quite different. Since 2000, it has had an average economic growth rate of 7 % per year. Norwegian-Russian trade has increased by 91.6 % and Norwegian exports to Russia have increased by 334 %, since 2000. Doing business in Russia involves big risks, not the least of which is due to the remaining imperfections of the Russian legal system. As such, the potential for massive profits is accordingly high. The present imperfections in Russian legislation may deter a law student from further examining this topic, or on the other hand, trigger a genuine interest to understand this evolving legal system. This thesis is a testament to the latter, and will therefore examine company law, which is one of the core elements of market economy regulation.

Another interesting aspect of writing about Russian law is the fact that for many foreign lawyers, businessmen and investors, Russian law may seem as something unknown and different. This thesis thus attempts to also cast light on a field of law that is practical from a foreign investment point of view. Moreover, the author hopes to reveal that Russia, despite some negative, high profile cases (for instance, the Khoderkovskiy-case), is after all for the most part a “normal country” in a certain sense of this expression.⁶

For Western entrepreneurs and investors, company law is essential. Foreign investment is made by company transactions, which include direct investments and portfolio investments into companies. Consequently, it is crucial for investors to understand how well the investment made into a company

⁵ T. Mathiesen ”Retten i samfunnet” (the Law in the Society), 5 edn, Pax, 2005; the “landscape” metaphor may be more commonly expressed in Anglo-American law as the concept of “law in books and law in action”. In his sociological work on the question of why some legal acts works better than others, Mathisen uses the term “landscape” as metaphor on the social environment of the law; i.e. in short, if the specific legal acts does not comply with and is adjusted the social phenomena it is supposed to regulate, the act will not work as intended.

⁶ It is referred to e.g. Shleifer & Triesman, *A Normal Country*, 83 Foreign Aff. 20 (Mar.-Apr. 2004), provided in p. 5 in Black, S B et al, *Report to Russian Center for Capital Market Development: Comparative Analysis on Legal Regulation of the Liability of Members of the Board of Directors and Executive Organs of Companies (English Language Version)* (February 2008). ECGI - Law Working Paper Series 103/2008 Available at SSRN: <http://ssrn.com/abstract=1001990>. The countries in comparison are, beside Russia, inter alia, Germany, UK and the U.S.. The Report was delivered December 2006 (hereinafter, Black et al).

is protected, and to what extent they may be able to maintain control of the company and its business operations. According to recent studies, the presence of legal and regulatory protections for investors explains up to 73% of investors' decisions of whether or not to invest in a foreign country.⁷ By contrast, company characteristics, i.e. the financial state of the company, explain only between 4 % and 22 % of this decision.⁸ According to *Doing Business 2009*, the Russian Federation scores only 5 points out of 10 in the Investor Protection Index.⁹ The level of investor protection is highly dependent on the extent of liability for managers.¹⁰ As the discussion in this thesis will show, there are several questions with regard to liability in company relations that are still not fully determined for an emerging field like Russian company law (in which the only liability for managers was criminal and administrative liability before 1992). Therefore, an important factor for attracting foreign investments into Russia is to clarify, and possibly expand, the extent of liability for managers. Central to this picture is the extent of liability for the *executive body* in Russian companies. The executive body possesses wide powers, according to Russian company legislation. This power can be abused or can be used in ways which may inflict losses on the company, and hence, indirectly on its shareholders.

1.2 Why the focus on executives?

When establishing or buying into a Russian company it is common practice to appoint a *Russian* CEO.¹¹ This has practical reasons; one being the slow bureaucratic process for obtaining work permits for a foreign CEO. As a matter of Russian statutory law, the executive body has the right to

⁷ See *Doing Business 2009, Europe and Central Asia*, by IFC (the International Finance Corporation). The *Doing Business* surveys by IFS (a World Bank Group) apply an evaluation of the degree of investors' protection as one out of ten main indicators to survey a country's business environment. The "Protecting Investors" measurement consists of, inter alia, mapping the extent of managers'/directors' liability, the extent of disclosure of information to shareholders and the ease of shareholder suits.

⁸ L.c.

⁹ *Doing Business 2009, Europe and Central Asia*, p. 18.

¹⁰ L.c.; In this thesis, the term "managers" is to be understood as a generic term referring to the members of the board of directors and the executive body.

¹¹ In this thesis, the term "CEO" (Chief Executive Officer) is to be understood as a single natural person holding the position as the executive body. In practice, this body may be called "president", "general director" etc.

With "executive"/"executive body", this is to be understood as nearly all forms of the executive body, but mainly indented at the CEO. The terms exclude, however, the collegial executive body (CEB). This is due to the fact that there are some particularities with regard to the CEB formation, and this is outside of scope of the thesis (see further section 1.4).

sign in the name of the company, to bind the company and to represent it.¹² From a shareholders' point of view, this makes the liability question with regard to executives practical due to their interests to restore losses in the company caused by the executive body. If a decent degree of trust is not already established with regard to the CEO, the question of how to obtain a sufficient degree of control over his business conduct is essential. It is possible to restrict the powers of the CEO by introducing suitable changes to the company's articles of association, but this may, on the other hand, lead to less efficiency in the daily business operations, as the executive will have less latitude when dealing with the daily business operations of the company. In this way, the question of liability for the executive body is essential for securing the interests of the investor.

In comparison to the U.S., for example, it should be added that the distribution of shares in Russian joint stock companies is quite consolidated.¹³ This, in combination with a tradition of heavy involvement of major shareholders in the day-to-day operations of companies, along with a lack of distinction between the company's property and the major shareholders' property,¹⁴ causes a need for strong legal protection of the interests of minority shareholders against a powerful corporate entity like the Russian executive body.¹⁵ To the extent that there is a lack of compliance with company laws, internal company documents like the articles of association and minority shareholder's rights, this can be considered a direct result of the domination of managers in many firms¹⁶

There are ongoing debates in Russian legal literature concerning the development of company legislation, and the legislation will probably continue to undergo major changes.¹⁷ The legal institution of damage claims in company relations is somewhat weakly developed in Russian law and practice.¹⁸ There have been relatively few cases against executives,¹⁹ though this number is

¹² His competence may be limited by the articles of association (see section 3.4); See Black, Kraakman and Tarassova, pp. 397-398.

¹³ P. 234 in Dobrovolskiy V I, *Protection of Corporate Property in the Arbitrazhnyi Court* (Защита корпоративной собственности в арбитражном суде), Moscow, Wolters Kluwer, 2006 (hereinafter, Dobrovolskiy).

¹⁴ It is referred to a conference held on corporate governance issues at Higher School of Economics in Moscow the 2nd-4th of November 2007.

¹⁵ Black, Kraakman and Tarassova, p. 16.

¹⁶ P. 231 in Wolk G, *Corporate Governance Reform in Russia: the Effectiveness of the 1996 Russian Company Law*, In: Pacific Rim Law & Policy Journal, vol. 8, no. 1, p. 219, 1999 (hereinafter, Wolk). The article is dedicated the problems with managers' strong position in Russian companies and the problems this cause with regard to minority (or even majority) shareholders.

¹⁷ Butler 2006, p. 35. Here it is expressed that Russian post-Soviet law as "embryonic" and "remains undetermined".

¹⁸ Black, Kraakman and Tarassova, p. 15.

increasing.²⁰ It is quite apparent, however, that this does not reflect the reality regarding infringements on the company by Russian executives.²¹ Another fact, emphasized by many Russian authors, is that a Russian executive will often not be solvent enough to restore the extensive losses in a big company. This is due to the fact that he is relatively poor compared to the losses the company incurred by him, and/or because his assets are hidden, which is still quite common in Russia. This does not, however, eliminate the potential importance of this remedy in corporate relations.²²

1.2.1 The legal concept of “liability”

Liability means the legal responsibility for one’s acts or omissions.²³ Generally, under Russian law, there are four types of liability that may be assigned to the executive: criminal, administrative, civil and disciplinary liability. This thesis only focuses on civil liability. However, other types of liability or other means of protection of rights do not limit a claim for damages.²⁴

¹⁹ When doing searches on Konsultant (the full version updated at Oktober 2008), one will find approximately 300 cases (the database provides decisions from Federal Arbitrazhnyi Courts and Supreme Regional Courts, which are third instances, in addition to the Supreme Court and Supreme Arbitrazhnyi Court) that are somehow connected to liability/responsibility (in Russian this is the same word) for the executive body (searches on the phrase “liability/responsibility for the executive body”). Notably, because of some shortcomings in the search tools, the same cases do not always appear and others appear twice (for instance, because a case might have been at first rejected on procedural grounds and then re-filed). Moreover, not all cases are registered in the system. However, a closer review of the cases found will show that only less than 50 will actually treat liability for the executive body. Approximately 40 of these will be based on the articles 71 in the JSC Act and 44 in the LLC Act. Many of the cases treating liability for the executive do not go into the substance of the claim for damages (especially is this the case if there are a variety of legal provisions that the claim is based on). The actual number of court cases that is actually worth examine is therefore low (cf. section 2.4.3). About one fifth of the cases are filed with the General Jurisdiction Courts and the rest with the Arbitrazhnyi Courts (see section 5.4).

²⁰ See p. 468 in Osipenko O V, *Conflicts with regard to the Operations of the Management Bodies in Joint Stock Companies* (Конфликты в деятельности органов управления акционерных компаний), Moscow, Statut Publishers, 2007 (hereinafter, Osipenko). P. 50 in Astapovich A, et al, *Corporate Reform and Harmonization of the Corporate Legislation of Russia and EU* (Корпоративная реформа и гармонизация корпоративного законодательства России и ЕС), 2nd edition, Moscow, Wolters Kluwer, 2007 (hereinafter, Astapovich); Black, et al p. 622; Black et al p.168 asserts that it is nowadays “rather frequently”.

²¹ P. 62 in Molotnikov A E, *Liability in joint stock companies* (Ответственность в акционерных обществах), Moscow, Wolters Kluwer, 2006 (hereinafter, Molotnikov).

²² This is emphasized in heading 4, section 5, subsection 7 in Makarova O A, *Corporate Act: Textbook* (Корпоративное право: Учебник), Moscow, Wolters Kluwer, 2005 (hereinafter, Makarova). The further paginating of this article will refer to the headings, as there is no paginating in the version provided in Garant database.

²³ See for example, <<http://legal-dictionary.thefreedictionary.com/liability>> or <<http://dictionary.law.com/default2.asp?selected=1151&bold>>; Hereinafter, the term “acts” and “actions” includes omissions.

²⁴ See commentary to article 15 in Sadikov O N (editor), *Commentaries to the Civil Code of the Russian Federation* (Комментарий к гражданскому кодексу РФ), Moscow, INFRA M, 2006 (hereinafter, Sadikov) (only the articles are referred to, as this book is provided by Garant database, which did not provide pagination).

A claim for damages is known as the remedy to restore a loss. The remedy aims at restoring damages caused by the fault (restoration motive), and serves as a measure to prevent people from failing to meet their responsibilities (prevention motive).

Civil liability is generally understood as a failure to meet a civil responsibility/obligation, whether it stems from a contractual relationship or a non-contractual relation. A failure will leave the *wrongdoer* (a legal or physical entity) open to a lawsuit for restoring damages caused upon the *sufferer*.²⁵ In this way, if one does not meet his responsibilities, he is *liable*. The essential difference between contractual and non-contractual liability is that the former is provoked when a party violates provisions in the contract (or legal provisions regulating and complementing the type of contract in matter), while the latter is provoked by tortious acting in a non-contractual relationship. As the relation between the executive body and the company is based on a contract, contractual liability will be targeted in this thesis.

There are several forms of civil liability, whether it is in relation to a contractual or non-contractual relationship. According to most Western legal systems, liability can be strict,²⁶ fault-based,²⁷ strict liability with exceptions from force majeure or so-called control-liability.²⁸

1.2.2 The concept of “executive body” in relation to the company and its shareholders

The executive represents the company in its daily business operations and signs in the name of the company. This implies that a third party’s claim, based on the actions of the executive in capacity of such, may only be directed against the company itself. Thus, it is the company, as a legal entity, that may become liable in its outward relations. Moreover, if we turn to the internal relationship between the executive and the company, this is based on a contract between two independent legal entities. This implies that the executive may become liable vis-à-vis the company (or vice-versa), if the executive fails to act in accordance with the contract (i.e. civil liability stemming from a breach of contract). More specifically, this contract is a *labor contract* insofar as the executive is not a

²⁵ The word “wrongdoer” is applied for the person that a claim for damages is directed at.

²⁶ This implies that the wrongdoer will be liable without regard to whether the act leading to the damage was done negligently or not. “Negligence” is the subjective condition of assessment under the fault-based liability.

²⁷ Fault-based liability is the type of liability taking into consideration the defendant’s negligent acting. Also called subjective liability or culpa liability, the pendant to strict liability.

²⁸ This type of liability may be compared to the strict liability with exceptions for force majeure. This type of liability implies a strict liability that is limited by the wrongdoer’s possibilities to prevent the fault, i.e. strict liability within his “sphere of control”.

managing company (for the managing company, see section 3.4.3.2). Generally inherent to contractual provisions are mandatory legal provisions or principles that regulate the type of contract, such as the Principle of good faith in contracts, which most Western legislations provide for in their law of contract.

The shareholder, as another legal subject, is not a part of the contractual relationship that exists between the company and its executive body. Therefore, as a starting point, they have no right to plead the company's claim for damages against the executive. However, as it is in most Western legislations, if certain preconditions are met, the shareholder is entitled to claim the company's loss against managers in the company on behalf of the company. This is due to the fact that if the company suffers an economic loss, it will indirectly harm the economic interests of the shareholder. The shareholder's right to claim for the company's damages is aimed at securing the shareholder's financial interests in the company (investor protection), as well as protecting the interests of minority shareholders. For example, a company has an obvious claim against the executive as a result of his misbehavior. However, the executive might control the majority of shares in the company and thus be able to prevent a claim for damages from the company. In this situation, the shareholder is entitled, under certain conditions, to pursue a claim on the company's behalf. This type of lawsuit is often referred to as an *indirect lawsuit* or a *derivate lawsuit*. The former term will be used in this thesis.²⁹

1.3 The objective, delimitations and structure of the thesis

The objective of this thesis is to clarify the norms and conditions regulating how the shareholders and the company can be awarded damages when the latter has suffered an economic loss on the basis of the executive body's improper actions. The thesis also assesses situations where a shareholder may claim a personal loss that results from the executive's actions. The main focus is on claims that are based on articles 71 in the Joint Stock Company Act (hereinafter, the JSC Act and 44 in the Limited Liability Company Act (hereinafter, the LLC Act).³⁰

²⁹ Cf. n 145 for an explanation of these terms.

³⁰ Federal Act on "Joint Stock Companies" of 26 December 1995 (Федеральный закон от 26 декабря 1995 г. N 208-ФЗ "Об акционерных обществах").

Federal Act on "Companies with Limited Liability" of 8 February 1998 (Федеральный закон от 8 февраля 1998 г. N 14-ФЗ "Об обществах с ограниченной ответственностью").

To comply with the objective, the thesis seeks to discuss the major components to be examined in a claim for damages against a Russian executive. The following is a brief overview of the thesis and its components, including the delimitations of the thesis.

As the thesis is written for non-Russian lawyers and the author is himself a foreign student of Russian company law, this calls for a more comprehensive account of methodological aspects and Russian sources of law, which is discussed in section 2. In section 2.1, comments on comparative method are provided. Comparative method deals with many similar problems that are encountered under the preparation of this thesis. The comparative elements throughout the thesis are mainly drawn from Norwegian law, with some Anglo-American and German law, to provide a bigger picture. In this way, it is sought to elucidate and illustrate, and to some degree evaluate, the features of Russian company law and liability for the executive. In order to provide a framework when examining the legal questions in this matter, section 2.2 reflects upon the sources of law in a Russian context, while sections 2.3-2.6 consist of an introduction to Russian sources of law and their application. Special attention is given in section 2.3 to the state of case law in Russia, since this differs from many other national jurisdictions, in particular common-law systems.

In section 3, an overview of the Russian corporate legislation is provided to give the reader references to the general concept of company law in Russia, as well as comparative references to other national jurisdictions. An overview is also included of the different types of companies that the Russian company legislation provides. The thesis focuses on Russian joint stock companies (hereinafter, JSC) and limited liability companies (hereinafter, LLC),³¹ as these are widespread and the conditions for an approbation of claims for damages against the executive body are quite

³¹ The term “JSC” includes so-called open and closed forms of JSC (see full reference to the JSC Act in n 30). The open ones have the abbreviation “ОАО” (открытое акционерное общество, ОАО), the closed ones have the abbreviation “ЗАО” (закрытое акционерное общество, ЗАО). The “LLC” has the abbreviation “ООО” (общество с ограниченной ответственностью) (see full reference to the LLC Act in n 30).

A limited liability company is usually understood in Western legislations as a type of company in which the liability for the shareholders for the debt of the company is limited to the share value. In this sense, also JSC companies are “limited liability companies”. Because of this, Butler 2003, pp. xix-xx, points out that it will be more accurate to translate the LLC as “limited responsible society”, in order to make this distinction visible and reserve the LLC form for the general conception of shareholders’ limited liability. In this thesis, however, the more widely known term “limited liability company” (“LLC”) is used when referring to companies in the LLC Act. (cf. Black, Kraakman and Tarassova, applying the term “limited liability societies” when describing the Russian company type LLC). Moreover “company” is translated in Russian to “общество”, which means “society”. In this thesis it is translated to “company” owing to the fact that for a foreign lawyer these terms are generally and easily understood, and moreover, the legal concept is the same. See for a more detailed reasoning of this matter in Black, Kraakman and Tarassova, p. 98; See Gashi-Butler and Butler, p. vii and Butler 2003 p. xiii-xvii.

similar.³² Furthermore, in section 3.4, an account is given of the various forms of the executive body. The executive body may have the form of a single general director, such as a CEO, a managing company, which is a legal entity, or a collegial executive body that consists of a group of persons. The CEO is the focus in the thesis since this type of executive body is the most widespread and the extent of this thesis does not allow for a more extensive analysis. Hence, any special features of the liability for the members of a collegial executive body (hereinafter, CEB³³) will not be discussed in this work.³⁴ It should be added that this form is rarely applied in Russia. In regard to the managing company, the thesis assesses the particulars on the liability of such an executive body.³⁵

As a result of the executive's action, he may be subjected to different types of claims from the company or the shareholders.³⁶ The constellation of different claims is discussed in section 4 and is provided as an overview of these claims. In this thesis, it is the company's direct claim (see section 4.1) and the shareholder's indirect claim (see section 4.2) that is in focus.³⁷ This is due to the fact that the stockholder's direct claim in certain situations (see section 4.3) has a more limited extent of application, while the shareholder's direct non-contractual claim (see section 4.4) may not turn out as a legally-relevant base for the claim. This legal remedy is not known to be utilized in company relations in Russia, and thus, only has more theoretical applications. Another type of legal remedy that is often closely connected to a claim for damages is the claim for invalidation of a deal. In the thesis, the invalidity remedy will not be discussed more than necessary for elucidating the regulations and the state of law concerning claims for damages.

Section 5 discusses commencing the claim before the courts and procedural problems in relation with a claim for damages against the executive.

³² See e.g. Black, et al p. 224.

³³ Russian: "коллегийного исполнительного органа общества"; Norwegian: "kollegialt utøvende organ" (hereinafter will pinpointing "Russian" and "Norwegian" in these translations discontinues).

³⁴ Much of what is discussed in this thesis, will, however, be relevant to the assessment of damage claims against the members of a CEB, as the thesis assesses standards in the fault-based liability.

³⁵ See particularly sections 3.4, 5.3, 5.4 and 7.6.

³⁶ The LLC Act makes use of the word "participant" and the JSC Act the word "stockholder". Both the participant and the stockholder own a share in the company's capital. In this thesis the term "shareholder" will be used when referring to both participants and stockholders as a generic term.

³⁷ A "shareholder's direct claim" in this thesis is to be understood as a claim from the shareholder against the executive, without the involving the company, or filing a lawsuit in the name of the company. The "company's direct claim" is understood as the situation, in which it is the company in its own name that commence the lawsuit, represented by its competent managing body.

Section 6 treats the material conditions for awarding damages in contractual relations that commonly applies to all contracts. As mentioned in section 1.3.2, the relationship between the executive and the company is of a contractual nature. In addition, there are special laws that regulate certain types of contracts and provide different legal bases for contractual liability. Such legal liability bases are discussed in sections 7 and 8.³⁸ Most of the focus in this thesis will be on article 71 in the Act on JSC and article 44 in the Act on LLC, since these are the main and general bases for liability for the executive body vis-à-vis the company, and thus, its shareholders. The liability bases in these articles are discussed in section 7. In order to give the reader an overview of special legal basis for a claim for damages, other than articles 71 and 44, this is treated in section 8. Many of these legal bases are, however, partly overlapping and serve as alternative bases.

In addition to basing the claim for damages on a liability basis, as discussed in section 7 and 8, the sufferer must present an economic loss as a result of the violation for being awarded damages. The economic loss condition is discussed in section 9. Furthermore, the economic loss must be caused by the violation (proximate cause). The causality condition is discussed in section 10. The two latter conditions are discussed with particular regard to article 71 in the JSC Act and 44 in the LLC Act.

³⁸ The legal concept of “liability basis” is not that widespread in Anglo-American law. In civil law communities this is, however, essential, as a claim for damages must be explicitly legally founded in a “liability base”. This is for instance a provision in a legal act or custom that entitles a sufferer to claim for damages on certain conditions (see for instance Craig, Ronald, *Norwegian – English Act Dictionary* (Stor norsk-engelsk juridisk ordbok), Oslo, Universitetsforlaget, 1999, under “ansvarsgrunnlag” [“liability base”], hereinafter, Craig).

2 Method and sources of law

2.1 Comparative method and coping with the language and cultural barrier

In a given legal system, the law consists of not only the written “raw” law.³⁹ The law in force is a product of refinement and interpretation of competent authorities, local lawyers, scholars and other applicants of the law.⁴⁰ Therefore, it is inevitable that a Norwegian student writing in English about Russian law will encounter some problems during the examining of the foreign law that he is not facing when examining his domestic legal system. Comparative method provides reflections on such problems when examining foreign law. Therefore, comparative method is discussed in the following, while also demonstrating that many of the methodical problems in this thesis are of a general nature.

Studying a foreign law-system creates particular problems. First, foreign lawyers lack the understanding of the *legal culture* of the jurisdiction in question.⁴¹ A lawyer is normally socialized into his national legal community with an understanding of the national history, religion and culture of that community. Knowledge of how the law works is naturally influenced by these internalized norms and perceptions. This forms a context of how the law is interpreted and understood in a given society, which the foreign lawyer or comparatist has to be aware of when examining the local law. For instance, “source of law” may be interpreted quite differently by Russian and American lawyers, particularly when it comes to case law. Furthermore, there are no any well-established comparative methods to overcome the barriers of adapting to a foreign legal culture.⁴² Bearing this in mind, and taking this into account when examining foreign law, the comparatist or foreign lawyer may be able to avoid such misunderstandings; in as much as he familiarizes oneself with national legal theory and the system of sources of law, beside the analysis of the written legislation.

³⁹ P. 870 in Vogenauer S, *Sources of Law and Legal Method in Comparative Law*, in: The Oxford Handbook of Comparative Law (Reimann M. and Zimmermann R. eds.), Oxford, Oxford University Press, 2006 (hereinafter, Vogenauer).

⁴⁰ L.c.

⁴¹ The term “legal culture” has been applied by some comparatists to identify some basic common comprehensions of legal realities between lawyers. See e.g. p. 175 in Mark van Hoecke *Deep Level Comparative Law* in: Mark van Hoecke (ed.): *Epistemology and Methodology of Comparative Law*, OR 2004, s. 165-195 (hereinafter, Hoecke), or David Nelken (hereinafter, Nelken D, *Legal Culture*, in: “Elgar Encyclopedia of Comparative Law” (Smits, J. S. ed.), Edward Elgar Publishing Limited, 2006-, who discusses more profoundly the definition and the concept of “legal culture”. The term of “legal culture” is much debated in comparative law literature, but essentially it provides a comprehension of law which is broader than the given sources of law within in a particular legislature.

⁴² See Hoecke pp. 167-169.

Second, studying the law in a foreign language complicates the interpretation of the law. Even within one language, words may have diverging denotations according to regions, professional groups, cultural background, etc. Nevertheless, when coping with foreign words and terms and their legal application, it is imperative that the comparatist understands the legal reality and the underlying conception of the term in the local legislation.⁴³ Nevertheless, the underlying concept is understandable for both. Thus, it is paramount that the comparatist or foreign lawyer gives the foreign legal language thoughtful reflection during their examinations of the local law. Accordingly, it is appropriate to provide a couple of remarks regarding some of the special features of the Russian legal system as a reference for what these differences might entail. To begin with, Russia has imported much of its legislation in the civil law sphere from other Western jurisdictions (see further section 3.1).⁴⁴ One of the main problems when importing legal models (e.g. a company model) is the understanding of the legal concepts (e.g. liability for managers⁴⁵) in these models.⁴⁶ Once imported, the concepts adapt to the national environment and the foreign origin of the imported legal concept may be taken into consideration only as a possible aid to understand and interpret it in a broader sense.⁴⁷ In this way, apparently similar concepts (for instance the concept of “limited liability company” or “fault-based liability”) do not necessarily implement all of the features from the original legislation, although the core elements remain the same. As Russia is characterized within the Romano-Germanic family and a part of Western legal culture,⁴⁸ many legal terms and concepts will be familiar for a student from a Western national jurisdiction, and especially a civil law jurisdiction. In this sense, a foreign student should be careful when encountering terms that are apparently equal to conceptions in his domestic law. It should be added, though, that most Russian comparatists categorize Russia today as a “transitional legal system”, belonging to neither the civil law system nor the common law system.⁴⁹ This is due to the fact that much of the legislation within the sphere of private law is imported from different Western legislations.⁵⁰ This makes it even more

⁴³ Hoecke pp. 174-175.

⁴⁴ The Russian civil law sphere can be compared to what is called private law in Norwegian.

⁴⁵ See definition of this term in n 10.

⁴⁶ P. 517 in Doronina N G, Semilutina and N G, *Employment of Foreign Concepts of Law and Definitions in Russian Market Economy Legislation*, in: Transnational Law & Contemporary Problems, vol. 13, p. 499, 2003 (hereinafter, Doronina and Semilutina).

⁴⁷ Ibid pp. 517-518.

⁴⁸ Butler 2006 p. 636; Hoecke p. 175.

⁴⁹ Butler 2006 p. 635.

⁵⁰ Pp. 289-290 in Burnham, Maggs and Danilenko *Law and Legal System of The Russian Federation*, New York, Juris Publishing Inc, 2004 (Hereinafter, Burnham, Maggs and Danilenko). Here it is laid out a short description of the origin

vital to examine the legal concepts and terms in the proper national context, as the original concepts and terms may not be consistent with the Russian understanding of them. The intent, therefore, is to give the reader an insight into the system of Russian sources of law and to dwell upon how essential legal concepts and terms in the sources examined in this thesis are actually applied.⁵¹

2.2 The concept of sources of law in Russian law

In order to make a just comparative study of foreign law, a comparatist inevitably has to deal with legal reasoning and legal methodology of the national law in question, and in particular the concept of “sources of law”. This term is widely expressed in Western legal culture (i.e. “source du droit”, Rechtsquellen, “fonti del diritto, Fuentes del derecho, “rechtsbronnen, “rettskilde” and the Russian “источник права”). Even within a jurisdiction this term may not be applied consistently, and amongst various national legal systems, the concept may comprise different legal understandings.⁵²

In legal systems which are dominated by a more *positivistic concept of law*, a narrower perspective of “source of law” prevails. A narrower perspective of the concept “sources of law” contrasts the *plurality thesis* of sources of law, which for example is prevailing in Norwegian legal theory.⁵³

Russia is an example of a legislation, in which a positivistic approach rules. Russian legal practice and theory has a rather formalistic approach to its sources and the hierarchy of sources is strict.⁵⁴ The most common understanding in Russia of what “sources of law” refers to is written law, which is adopted by the competent body in correct forms.⁵⁵ Below, in section 2.3-2.7, various sources of law are delineated. This is based on the sources that are acknowledged in a national legislation with a pluralistic approach, like the Norwegian legislation, in order to give a broader account.

of the Russian Civil Code; Doronina and Semilutina p. 499, 2003 give some examples of foreign concepts of law and definitions imported into the Russian market economy legislation.

⁵¹ All translations are the author’s own (with the help of dictionaries like www.multitrans.ru and ABBYLingvo) as there are not, insofar as the author is aware of, any official translations. Where there are quotes, the Russian wording has been provided for in footnotes. Some central terms is also translated into Norwegian.

⁵² Vogenauer, p. 877.

⁵³ See eg Graver H P, *The Emporers Wardrobe: The Teachings of Eckhoff’s Doctrine of Sources of Law and Future Challenges* (Keiserens garderobe: Eckhoffs rettskildelære og utfordringer fremover), in: “Journal of Legal Theory” (Tidsskrift for rettsvitenskap), p. 429, 2000.

⁵⁴ Butler 2006, p. 631; Burnham, Maggs and Danilenko, p. 23 are discussing the evolvement of general principles and natural law, despite the “prevailing doctrine of legislative positivism” in Russia.

⁵⁵ See for instance the Yandex Big Legal Dictionary (<<http://slovari.yandex.ru/dict/jurid/>>) under “source of law” (“источник права”). The term “sources of law” is in many cases connected with the term “normative acts” (“Нормативные акты”), which means adapted acts by the legislator. The Journal of Russian Law (Журнал российского права) regularly provides articles on this topic, showing some of the ongoing debates in this legal field.

2.3 The Russian legislative hierarchy – the written law

The sources of law are indirectly deducted from the provisions in the constitution. More precisely, the provisions govern the adoption of legal acts from various bodies with a legislative authority and these legal acts are the “sources of law”.⁵⁶ The Constitution has the highest rank. International law and convention takes priority in cases of contradiction to other legal acts, pursuant to the Constitution article 15, section 4. Thus, the Russian approach to international law and conventions is monistic, so that after ratifying a convention, it is considered binding for the courts as internal law. Furthermore, there are Constitutional Acts, which are rare and not relevant to questions that concern the subject matter in this thesis. The most widely applied sources of law are “federal acts”⁵⁷ Some are called “codes”⁵⁸ and other called federal acts, but they have the same rank. The codes are often of a more general nature, while federal acts are of more specific nature that supplement existing codes; in particular this is the case with regard to the Civil Code in relation to other federal acts within the civil law sphere (see section 3.2).⁵⁹

Other governmental acts include Presidential edicts, federal bodies’ legal acts, acts adopted by federal subjects. These must not be contrary to the legal acts at the federal level, and they do not touch upon issues related to civil liability.

Furthermore, the Constitution’s delineated sources of law are reaffirmed as sources by Arbitrazhnyi Procedural Code⁶⁰ (hereinafter, APC) article 13, section 1 and Civil Procedural Code⁶¹ (hereinafter, CPC) article 1, section 3 article 1, which more specifically list sources of law in the civil legislation. For instances, analogies in the civil law sphere is provided for, pursuant to the APC, article 13, section 6 and the CPC article 1, section 3 (for an explanation of the *Arbitrazhnyi* court, see section 2.4.2), as well as in the Civil Code article 6. Insofar as the author has been able to reveal, the court is extremely cautious to extend the wording or apply analogies with regard to company law.

⁵⁶ E.g. Butler 2006, p. 632 is listing up the Russian sources of law; See e.g. Burnham, Maggs and Danilenko chapter II, for a more elaborated description of the Russian sources of law.

⁵⁷ “Федеральный закон”; “federal lov”.

⁵⁸ “Кодекс”; “kodeks”.

⁵⁹ “The Civil Code ” part 1 30 November 1994, part 2 26 January 1996, part 3 26 November 2001, part 4 18 December 2006 (Гражданский кодекс Российской Федерации часть первая от 30 ноября 1994 N 51-ФЗ, часть вторая от 26 января 1996 N 14-ФЗ, часть третья от 26 ноября 2001 N 146-ФЗ и часть четвертая от 18 декабря 2006 N 230-ФЗ).

⁶⁰ “The Arbitrazhnyy Procedural Code” of 24.07.2002 (Арбитражный процессуальный кодекс Российской Федерации от 24 июля 2002 N 95-ФЗ).

⁶¹ “The Civil Procedural Code” of 14.11.2002 (Гражданский процессуальный кодекс РФ от 14 ноября 2002 N 138-ФЗ).

Furthermore, it is mentioned that the court may also apply, “custom business practice”,⁶² if such application is provided for by the material legal acts in questions, as for example it is provided for in the Acts on JSC and LLC, articles 71 and 44.

2.4 Russian Courts system and juridical practice as sources of law

2.4.1 Judicial practice as source of law

Russia is considered a civil law country,⁶³ where the court system is in principle not a creator of law and, and is therefore fully bound to the legal acts adopted by the legislature.⁶⁴ Additionally, the court system was weak and ineffective during the Soviet-era, and under the communist regime, case law was excluded. The Constitution does not mention case law, neither do APC or CPC, which implies that this is not a formal “source of law”.

However, precedent is now gaining momentum.⁶⁵ Naturally, often will the wording of the legal act in question not apply to the concrete case. Thus, there is a need to clarify the application of the law, contradictions and unclear wording in legal acts and to secure the unity of court rulings. Because of this, there is an ongoing discussion of whether or not to recognize precedent more formally. Judicial practice is increasingly being recognized in Russian legal doctrine and practice as a source of law, whether in the form of juridical decisions having the value of precedents, or in the form of judicial explanations (for an example in a Information Letter, see next subsection) filling gaps in legislation or offering interpretations of provisions.⁶⁶ The Russian Supreme Arbitrazhnyi Court (hereinafter, SAC) and Supreme Court (hereinafter, SC) refer to their own practice in their resolutions, as do the

⁶² “обычай делового оборота” (this term is translated with several nuances, e.g. “usual business practice”, “good business custom” etc”; Norwegian; “sedvanlig forretningsomsetning” (this is literally translated, a translation implying more of the legal reality would be “sedvanlig forretningspraksis”).

⁶³ See eg Doronina and Semilutina, p. 510.

⁶⁴ Burnham, Maggs and Danilenko, p. 15.

⁶⁵ Pp. 145-146 in Roudik P, *How to Conduct Research in Russian Law*, in: International Journal of Legal Information, vol. 28:1, p. 143, 2000 (hereinafter, Roudik); Burnham, Maggs and Danilenko, p. 15 et seq. This is also the author’s own impression when discussing with Russian scholars.

⁶⁶ Butler 2006, p. 632; Roudik, p. 146.

lower courts.⁶⁷ Furthermore, it is widespread practice amongst barristers to refer to court practice, and in legal literature it is widely referred to when accounting for, and discussing the state of, law.⁶⁸

When studying Russian law, one frequently encounters the perception that the “real problems in Russia have not been so much the legislation itself, but *how* and *whether* it is applied, *who* applies it, and whether it is changed when it no longer corresponds to reality”.⁶⁹ These problems have also been addressed in connection with the application of the JSC Act and the LLC Act, as well as to the numerous incidences where companies failed to comply with the JSC Act at the expense of investors.⁷⁰ Although the JSC Act relied on a “self-enforcing” concept (see section 3.1), the courts conscientious compliance with the law is essential.⁷¹ The courts are doing better in this regard today than when the Act was adopted in 1995,⁷² but problems remain. For instance, besides a correct application of the law, there are problems with executing a favorable court ruling (see section 5.3.1).

2.4.2 The Russian court system

In Russia, there are three court systems: the Constitutional Court, the Court with General Jurisdiction (hereinafter, GC) and the Arbitrazhnyi Court (hereinafter, AC). The latter two have the Supreme Court (SC) and the Supreme Arbitrazhnyi Court (SAC), respectively, as the highest instances. The AC is a special court with “jurisdiction within the sphere of business and economic activity”,⁷³ according to article 1, APC. As a main rule, the AC deals with cases between legal persons, while the GC deals with cases between physical persons and between legal persons and physical persons. In the latter cases, however, there are exceptions with regard to cases between a company and company managers or former managers (see section 5.4), as these cases mostly adhere to the jurisdiction of the AC. This split court system between the AC and the SG has no parallel in the private law sphere of most western countries.⁷⁴

⁶⁷ See for further elaborations with regard to increasing emphasis on court precedent in Burnham, Maggs and Danilenko pp. 15-22.

⁶⁸ See e.g. p. 8. in Ivanov I V, *Principles Regulating the Operations for Managers in Joint Stock Companies* (Принципы деятельности управляющих акционерного общества), in: “Journal of Russian Law” (Журнал российского права, no 5-6, pp. 1-10, 1999 (hereinafter, Ivanov 1999).

⁶⁹ P. 272 in Gogek D, *Russian Company Law Reform: Have Flawed Laws Impeded the Transition to a Market Economy*, In: McGill Law Journal/Revue De Droit de McGill, vol. 41 p. 269, 1995 (hereinafter, Gogek).

⁷⁰ Wolk, p. 219. He comments in his article on several such incidences.

⁷¹ Black, et al, pp. 4-5.

⁷² See e.g. *ibid*, p. 5.

⁷³ “Правосудие в сфере предпринимательской и иной экономической деятельности”.

⁷⁴ See e.g. Black et al, p. 183.

The GCs consist of *district courts* on the first and second instances, and serve as the second instance for the *peace court*.⁷⁵ The third instance is the Supreme Courts of the republics. The highest instance is the Federal Supreme Court.

The AC consists of 82 first instance courts throughout the Russian Federation.⁷⁶ The second instance is called the “appellate” court.⁷⁷ The third instance is the Regional Federal Arbitrazhnyi Court (hereinafter FAC), which usually is the highest level. This is also called the “cassation” court,⁷⁸ depending on the type of appeal. FAC can serve as both a third instance and second instance, thus bypassing the appellate court in certain type of cases.

The SA and AC have supervisory functions over the FAC and the Supreme Regional Courts and may accept appeals from FAC and the Supreme Regional Courts in rare situations. Such judgments are called “Resolutions”.⁷⁹ A second type of “Resolution” from the SAC and SC explains the Courts’ interpretation of specific legal provisions. In addition, the third type of judicial statement from the SAC and SC is called an Information Letter.⁸⁰ This is an overview of how certain provisions should be understood, according to questions that have appeared in practice.

2.4.3 The configuration of judgments

Judgments are formulated quite briefly and explicitly.⁸¹ In the cases examined by the author, the typical design of decisions is to introduce the parties and the claim, refer to the legal basis and apply the provisions on the facts. When applying the provisions on the facts, the court can merely state whether the assertions of the claimant were proven or not. Subsequently, it concludes by affirming or denouncing the claim. In this manner, the courts do not profoundly show how the provisions were interpreted on the subject matter, and why the provision in question led to the conclusion. This makes it hard to derive any deductions on how the provisions in the relevant legal acts are actually applied and interpreted. In relation to the assessment of the fiduciary duties that are stipulated for the

⁷⁵ See the homepage of the Supreme Court <www.supcourt.ru/eng>.

⁷⁶ See for instance the Supreme Arbitrazhnyi Court’s homepage <www.arbitr.ru/eng>.

⁷⁷ “Апелляционной”; “anke”.

⁷⁸ “Кассационной”; “anke”.

⁷⁹ “Постановление”. See same translation in Roudik, p. 144; “resolusjon”/”dom”/avgjørelse.

⁸⁰ “Информационное письмо”.

⁸¹ Burnham, Maggs and Danilenko, pp. 391-392 lay out more formally the prescribed content of the judgments. Furthermore, (p. 392) it is stated that Russian judicial decisions are “relatively short compared to those in common-law countries and even in some other civil-law countries.”.

executive in articles 71 of the JSC Act and 44 in the LLC act (see section 7), the court often avoids discussing why an action was, or was not, considered “reasonable”, “loyal” and “in good faith”. Consequently, it does not leave much of a guideline for an assessment of these standards.⁸²

2.5 Doctrinal writings and legal literature

Legal literature and doctrinal writings are not a source of law in Russia. The courts do not refer to literature in court decisions.⁸³ However, lawyers commonly refer to literature in their argumentation during court proceedings.⁸⁴ Besides, Russian scholars are the senior figures in the Russian legal establishment, and thus able to indirectly influence the legislation process.⁸⁵

2.6 Preparatory works

In Norway, use of preparatory work of legal acts plays a major role as a source of law. In Russian law, however, preparatory works are not considered as a source of law, not applied by the courts and rarely commented upon by scholars and practitioners.

2.7 The application of sources of law in this thesis

Due to the fact that the legal field of the subject matter has only existed in Russia for 15 years, it is still being developed and occasional shortcomings remain.⁸⁶ Thus, an exposition of this field of law will inevitably seem a bit “superficial” in comparison to more developed fields. In comparison, Norwegian law is based on more than one hundred years of legislation, so court practice and theory has naturally resulted in a more nuanced state of law. For example, when examining Russian literature in this field, it is apparent that there are diverging views and different understandings among authors. Court practice also reveals different understandings of the conditions for awarding damages. However, unsettled legal questions can be identified in all types of jurisdictions. In this thesis, the approach has been to stick strictly to the wording of the provisions as the primary source when laying out the discussion, which is in line with the positivistic approach to source of laws (see section 2.2). As far as possible, the author has attempted to utilize court practice in the discussion,

⁸² E.g. see North-Caucasian District Court, 17 August 2006, no. F08-3470/2006. This resolution is so brief that it is not possible to properly review the reasoning of the court with regard to the subject-matter of the case.

⁸³ E.g. Burnham, Maggs and Danilenko, p. 392.

⁸⁴ Butler 2006, p. 633.

⁸⁵ L.c.

⁸⁶ See e.g. Astapovich, pp. 49-51.

despite the fact that this approach is not officially recognized as a source of law and the court practice is quite briefly substantiated (see section 2.3.3).

Furthermore, a main resource for this thesis has been Russian legal literature. Although it is not a source of law, it is an important legal resource for practitioners and provides an understanding of the legal reasoning. The latter is particularly true, seeing that the comparatist's need to understand the legal environment and legal culture is taken into account.

The last point to be mentioned is the challenge of ensuring that all relevant sources and aspects of the addressed questions have been thoroughly researched, since the author is a foreign student that is working within limited time constraints. Nevertheless, the author has been able to follow nearly all essential references and cross-references to legislative acts, court practice and theory that have been provided in relevant articles, books and court practice.⁸⁷ The resources for the thesis consist of several books, articles and electronic legal database tools, such as "Garant" and "Consultant".⁸⁸ In addition, in order to ensure the correct Russian perspective, the author has carried out several conversations and interviews with Russian scholars.⁸⁹ Nevertheless, due to some incompatible, diverging perspectives with regard to liability questions for executives, several aspects of the state of law will in this thesis be left undetermined.

⁸⁷ However, the reader should be aware of the possibility for that some relevant material might have been missed out.

⁸⁸ These legal bases are the most widespread legal tools in Russia and contain legal acts, written theory and court practice.

⁸⁹ These have been, inter alia, Molotnikov (researcher Moscow State University, Tshaikovskaya (Professor Higher School of Economics), Starzhenetskiy (Head of the International Department at the Supreme Arbitrazhnyi Court).

3 An overview of Russian company legislation

3.1 Russian company law in its historical context

In order to carefully examine the state of law with regard to a complicated topic such as liability for the executive body, an account of the legal-historical context of the field of company law is given in this subsection, and more specifically the history of the making of the acts.

In this thesis, “company law” is used in the conventionally understanding as “the law that articulates company structure and regulates relationships among shareholders and between shareholders and company managers.”⁹⁰ Moreover, the term “company law” is not a uniform concept in Russian law.⁹¹ According to many Russian scholars, such concepts may be perceived as “entrepreneurial law”, commercial law” or “corporate law”.⁹² The distinctions and naming of legal branches in the civil law are not all settled in Russian theory and it is a subject of ongoing debate. The term “corporate law”⁹³ has, however, gained a foothold.⁹⁴

Most jurisprudential trends in the last century bypassed the legal thinking during the Soviet-era.⁹⁵ Generally, the “private law eradicated under Soviet-times ... and rendered it lifeless”.⁹⁶ Thus, the re-creation of civil law was essential after the break-down of the Soviet Union.⁹⁷ During the Soviet-era, Russia had little need for an extensive regulation of companies and it was limited to some general regulation on trading associations.⁹⁸ However, the legal phenomenon of the “company” was not a totally new legal concept. As Gogek points out, before the revolution and during the N.E.P. period of the 1920’s, company legislation existed, and some comprehensive company acts were adopted in the Soviet Union from 1987-1990.⁹⁹ Moreover, the dissolution of the

⁹⁰ Black, Kraakman and Tarassova, p. 20; see n 10 for definition of the term “manager.

⁹¹ P. xiii in Butler W E, *Russian Company and Commercial Legislation*, Oxford, Oxford University Press, 2003 (hereinafter, Butler 2003). Here it is pointed out that the word “company” has no adjectival form, thus the term “company law” is not an accurate translation).

⁹² Gashi Butler and Butler p. vii; Butler 2003 p. xiii.

⁹³ “корпоративное право”

⁹⁴ The authors own experience while being a student at Moscow State University, fall 2007. For more details with regard to this discussion, see e.g. Butler 2003 p. xiii et seq.

⁹⁵ Butler 2006, p. 635.

⁹⁶ Alekseev, p. 468.

⁹⁷ L.c.

⁹⁸ Black, Kraakman and Tarassova, p. 9.

⁹⁹ Gogek, pp. 272, et seq.

Soviet Union resulted in greater receptiveness to interdisciplinary approaches to legal phenomena and concepts in the civil law.¹⁰⁰

Russian civil law is, to a large degree, imported from the German legal system.¹⁰¹ In several instances, one might say that Russian legislation has gone through several generations, moving sometimes to or from Anglo-American approaches to continental European approaches.¹⁰² The Act on JSC is often considered to have been significantly influenced by U.S. company law and by the German law on joint stock companies.¹⁰³ This hybrid becomes visible when the Act's composition of the company's management structure is examined. The Russian JSC Act and LLC Act alternatively provide a two-tiered board system, in which a supervisory board of directors may be formed in addition to the executive body (which is common in Germany and Norway), and a one-tier board system, which consists of only the executive body (which is common in the UK and U.S.).¹⁰⁴

A one-tier board system is a board of directors which usually consists of executive directors and non-executive directors. It is the CEO¹⁰⁵ that heads this board. Thus, there is only the executive body (as collective executive body, or alternatively only with a CEO) and no formation of a supervisory board of directors. A two-tier board of directors system implies that there is an executive body, headed by the CEO (or just the CEO without the formation of a collective executive body), who is subordinate to a separate supervisory board of non-executive directors.

The modern regulation on JSC started with a regulation on JSC adopted in 1990 together with a number of other legal acts that regulated JSC.¹⁰⁶ There were several shortcomings of these early regulations and a main defect was that the regulation was not well adapted for a planned economy that was transitioning into a market economy.¹⁰⁷ In 1993, a working group of lawyers, including foreign legal experts, started to draft a new act on JSC. An important aim was to make the act

¹⁰⁰ Butler 2006, p. 635.

¹⁰¹ Black, et al, p. 15.

¹⁰² L.c.

¹⁰³ Black, et al, p. 17; Motonikov, p. 152.

¹⁰⁴ Black, et al, pp. 10-22, laying out the details of the two-tiered and one-tiered boards with regard to the countries in comparison.

¹⁰⁵ See definition of this term in n 11.

¹⁰⁶ Black, Kraakman and Tarassova, p. 9.

¹⁰⁷ L.c.

attractive for foreign investors.¹⁰⁸ Due to the fact that Russian courts at that time worked quite slowly, most judges were educated in the Soviet-era and there was a general lack of understanding of business regulation, the company law had to depend on courts as little as possible.¹⁰⁹ The drafting was based on a principle called “self-enforcing” company law. The core of this model was an effort to harness the incentives of participants¹¹⁰ in the company, especially large minority shareholders, in order to provide meaningful protection to these shareholders despite the absence of the multiple private and public enforcement resources of developed countries.¹¹¹ One way to obtain “self-enforcement” is to create bright-lined and clearly defined statutory provisions.¹¹² The new Act on JSC was adopted in 1995, although with several amendments from the draft made by the Russian Duma. Over time, the JSC Act has undergone major revisions, most notably in 2001 and 2006.

The Act on LLC was adopted in 1998 and is similar in structure and concept to the JSC, but is intended primarily for small business.¹¹³ This Act is considered to have been significantly influenced by the German Act on LLC.¹¹⁴

3.2 The Civil Code and the relations to other federal acts

The Civil Code regulates most of the civil law (or private law) in Russia, and the Code “must be regarded as a pivotal act of the civil legislation as a whole”.¹¹⁵ For example, it regulates every type of contract, regulation on inheritance, intellectual property, civil liability and company types and structure. It contains four parts, and it is the first part that is essential to the subject-matter of this thesis. The first part consists of 453 articles, with the numbering of the articles running continuously through all four parts. The first chapter of the first part is called “general regulations”.¹¹⁶ This chapter outlines basic features and outlines of legal and physical entities, including the different types of companies. The second chapter is named “Property rights and other rights in rem”.¹¹⁷ The third chapter is named “General part of the obligation law”.¹¹⁸ This chapter

¹⁰⁸ Ibid, p. 26, pointing out that some well-publicized cases (in early in the nineties) of manager mistreatment impaired on the willingness for foreign investors to buy shares in Russian firms.

¹⁰⁹ Black, Kraakman and Tarassova, p. 15.

¹¹⁰ See definition of this term in n 36.

¹¹¹ Black, Kraakman and Tarassova, p. 89.

¹¹² L.c.

¹¹³ Ibid, p. 98. Gashi-Butler and Butler, p. xi.

¹¹⁴ Black, et al, p. 639.

¹¹⁵ Burnham, Maggs and Danilenko, p. 291.

¹¹⁶ “Общие положения”, “generelle regler”.

¹¹⁷ “Право собственности и другие вещные права”, “eiendomsrett og andre tinglige rettigheter”.

contains, inter alia, regulation on contractual liability. Part two regulates special types of obligations. Here, inter alia, non-contractual liability is regulated. The remaining parts of the Civil Code have no relevance to the subject-matter of this thesis.

In addition, there are several special federal acts which provide particular regulations and supplement the Civil Code. In this way, company law consists of the Civil Code and the special acts that regulate various aspects of company regulation.¹¹⁹ Examples include federal acts like the Acts on JSC and LLC, the Federal Act on “Foreign Investments” and the Federal Act on “Competition and Limitations of Monopolistic Activities in Commercial Markets”, just to mention a few.¹²⁰

Occasionally, the system with general and several special acts may lead to overlapping provisions. A general principle of the interpretation of Russian legislation stipulates that if two sources of law on the same level contradict each other, the more specific law should be referenced.¹²¹ The Civil Code, however, postulates in article 3 that other federal acts must comply with the Code (insofar as the provision in the Civil Code is not facultative, thus, it derogates in favor of other federal acts and, if specified, contracts). However, as is the case with liability as well as with other regulations, there will be several provisions in the Civil Code providing a framework regulation on liability, which supplements the special legal bases for liability in the various special federal acts. Thus, instead of trying to solve an apparent overlap between a general provision in the Civil Code and a provision in a federal act by favoring one to another, the question is more of interpreting the federal act provision in the light of, and supplemented by, the provisions in the Civil Code.

Besides the Civil Code and the Acts on JSC and LLC, the Labor Code regulates the relationship between the executive and the company, as this relationship is based on a labor contract. Today, there are ongoing discussions in Russian literature on how the company legislation and the labor legislation relate to each other, and the questions of whether the labor legislation or the company

¹¹⁸ ”Общая часть обязательственного права”, ”generell obligasjonsrettslig del”.

¹¹⁹ Black, Kraakman and Tarassova, p. 99.

¹²⁰ Federal Act on “Foreign Investments” of 9 July 1999 (Федеральный закон от 9 июля 1999 г. N 160-ФЗ ”Об иностранных инвестициях в Российской Федерации”) and Federal Act on “Competition and Limitations of Monopolistic Activities in Commercial Markets” of 22 March 1991 (Федеральный закон от 22 марта 1991 N 948-1 ”О конкуренции и ограничении монополистической деятельности на товарных рынках”).

¹²¹ Black, et al, p. 122.

legislation is the main regulator of this relationship.¹²² Pursuant to article 69, section 3, subsection 3 in the Act on JSC, other legislation is subordinate to this Act in cases of contradictions. In this way, it seems that the JSC Act takes priority. Such subordination is not mentioned in the Act on LLC. If the same applies, this deduction would rest upon an analogy. However, according to article 5 in the Labor Code, other legal acts containing provisions that define the labor relationship (in the same manner as company legislation) must comply with the Labor Code. Both the labor legislation and the company legislation enjoy the same rank, thus, the Lex Superior rule does not solve the problem. The Lex Specialis rule does not help in this situation either, as it can be argued that both the Labor Code and the JSC and LLC Acts are “specifically” applicable to the relationship. On the one hand it is a special type of labor relationship and on the other hand the labor relationship is a special relationship within the general company legislation.¹²³ This causes problems when attempting to fire the executive, to garnish his compensation, etc. With regard to liability, these questions do not influence the conditions for claiming damages on the basis of articles 71 and 44. However, the Labor Code provides an alternative base for liability (see section 8.1).

3.3 Types of companies

Russian company legislation provides for a range of different legal entities. They can be divided into two groups: companies with limited liability for its shareholders and those with full liability. Companies with full liability include individual companies (sole proprietorship), partnerships and agricultural cooperatives.¹²⁴ A hybrid between full and limited liability companies is supplementary liability companies (limited partnership). There are three types of companies with limited liability that are specifically regulated by the JSC Act and the LLC act, in addition to the general regulations in the Civil Code. There are two types of JSC: an open and closed one,¹²⁵ both of which are regulated by the Act on JSC. The open one is aimed at large companies, and is often registered at the stock exchange market. The closed one is typically intended for smaller companies of no more than 50 stockholders¹²⁶ (according to the JSC Act, article 7), in which there is a limited option to transfer stocks to third persons. The regulations concerning liability for managers are the same for both

¹²² See e.g. Black, et al, p. 123 or Masjin B M, *The Legal Status for the CEO in Economic Organizations: Apparent Conflicts in Civil and Labor Law* (Правовой статус единоличного исполнительного органа хозяйственного общества: мнимый конфликт гражданского и трудового права), in: “Legislation” (Законодательство), no 5, 2006.

¹²³ Black, et al, p. 122.

¹²⁴ Butler 2003, pp. xix-xx.

¹²⁵ Cf. n 20.

¹²⁶ See definition of this term in n 36.

types. More precisely, the main liability base is article 71. The third type of company is one with limited liability (named “ООО”). These companies are usually small companies consisting of participants who each own a part¹²⁷ of the company and usually are participating more actively than shareholders in joint stock companies.¹²⁸ The LLC form is more widely used by foreigners that are establishing companies in Russia.¹²⁹ The LLC has become quite popular, and today rather large enterprises are utilizing this approach. The LLC is largely similar to the closed JSC,¹³⁰ and there has been an ongoing discussion to phase out the closed JSC construction. The similarities of these three types of companies with limited liability allow for a common assessment of the liability for the executive.

3.3.1 Types of companies compared to Norwegian law

In Norway, the Act on Limited Liability Companies (hereinafter, the Norwegian LLC Act) and the Act on Joint Stock Companies (hereinafter, the Norwegian JSC Act) are parallel acts that regulate companies with limited liability.¹³¹ The former is intended primarily for small businesses and the latter for larger businesses. Both the closed JSC and the LLC might be compared to the former, while the latter is similar to the Russian open JSC.

3.4 Governance of the LLC and JSC and competence of their bodies

The Civil Code article 53 states that a company is operated through its bodies. The article does not say anything more than what is more profoundly regulated in the special Acts on JSC and LLC. There are more theoretical discussions in Russian legal literature about the legal nature of the relationship between the company bodies and the company.¹³² In modern Russian legal literature, however, this does not play any role in relation to liability questions.¹³³ There are mandatory and optional bodies of governance in the JSC and the LLC. The following includes an outline of these various bodies.

¹²⁷ “Part” LLC is equivalent to “stocks” in a JSC. The generic term used in the thesis is “share”. The “share” is a share of the *company capital*.

¹²⁸ Black, Kraakman and Tarassova, p. 89.

¹²⁹ The author’s own experience while working in Russia; Gashi-Butler and Butler p. ix, are adding that ZAO is also frequently used by foreigners.

¹³⁰ Gashi-Butler and Butler, p. ix et seq. Here it is pointed out some special features that distinguish the ZAO from the LLC. However, these particularities do not concern the liability questions.

¹³¹ “Lov om aksjeselskaper” (“aksjeselskapsloven”) (Act on LLC) of 13/06, 1999 nr 44 and “lov om allmennaksjeselskaper” (“allmennaksjeselskapsloven”) (Act on JSC) of 13/05, 1999 nr 45.

¹³² Molotnikov, p. 152, et seq.

¹³³ Ibid, p.154.

3.4.1 The general meeting

The general meeting of shareholders (hereinafter, GM) meets at least once a year (the Acts on JSC and LLC article 34 and article 47) and is the highest ranking body in the company (the Acts in JSC and LLC article 47, section 1 and article 32, section 1).¹³⁴ The GM consists of all of the shareholders in the company. Its competence is exhaustively regulated in the Acts. As the highest ranking body of the company, the GM decides upon, inter alia, the sort of governance structure that the company shall have. The GM constitutes the articles of association and elects members to the Board of Directors (hereinafter, BD) if the articles of association stipulate a two-tiered board system. If a one-tier model with only one level of governance is chosen for the company's governance, the GM chooses the CEO and/or the members of the collegial executive body. Alternatively, a managing company may be hired as the executive body. The BD's competence, as it is stipulated in the Acts, is transferred to the GM when the BD is absent.

If a BD is formed in a JSC and it is provided for in the articles of association, the BD will form and hire the CEO. Otherwise, the GM must form and hire the CEO. The power to fire the CEO is assigned to the GM, but this competence may be transferred to the BD (the Acts on JSC and LLC, article 48, section, 1 subsection 8 and article 32, section 2). In an LLC, the GM holds the exclusive competence of forming, hiring and firing the executive body.

3.4.2 The board of directors

The formation of a supervisory BD is mandatory in a JSC with more than 50 stockholders (JSC Act, article 64), which implies that in any closed JSC, the formation is optional since there cannot be more than 50 participants. The BD is optional in LLC according to article 32, section 2, of the LLC Act. If the BD is formed (which is more widespread, and which also provide the shareholders with more control), the governance system becomes a two-tiered board system involving two levels of governance. This implies that the BD will then supervise the CEO, the collegial body or the managing company.

¹³⁴ “Общее собрание”, ”årsmøte”.

The BD's competence in both JSC and LLC consists of organizing the GM, generally supervisory functions and the compilation of strategies for the company. The BD can only consist of physical, as opposed to legal, persons.¹³⁵ Its competence is defined in the Act on JSC, but may be extended by the articles of association. In LLC, the formation of competence is largely left to the articles of association and the competence is less restrained by the Act than the regulation in the JSC Act. The supervisory functions are, in essence, the same as in Norwegian Acts on LLC ("aksjeselskapsloven") and JSC ("allmennaksjeelskapsloven"), pursuant to their respectively articles 6-13 (parallel articles in the two Acts). An important difference is that the BD in Norway holds the right to represent the company externally and has the power to sign in the name of the company (facultative), according to the Acts' respective articles 6-30.

3.4.3 The executive body

The executive body is mandatory for every type of company. The executive acts in the name of the company without requiring power of attorney (the Acts on JSC and LLC, article 69, last section and article 40, section 3, number 1), and signs on behalf of the company. The Acts elaborate on this by stating that the executive must take care of the day-to-day operation¹³⁶ of the company (the Acts on JSC and LLC, article 69, section 1 and article 32, section 4). The limit of his competence is governed first by the principle of remaining power.¹³⁷ This implies that all competence that is not assigned to an upper body (the GM or the BD) remains at the lower body. Such assignment may be provided by statutory law or by the articles of association of the company (the Act on JSC, article 69, section 2, the LLC Act article 40, section 2, subsection 4 and article 53 in the Civil Code). The GM, holding the competence to decide the content of the articles of association, may, by means of these articles of association, limit the competence of the executive. For instance, the GM might transfer the right to sign in the name of the company on all deals involving more than a certain amount of rubles to the chairman of the BD.

The following summarizes the different types of executive bodies.¹³⁸

¹³⁵ Letter FFMS (Federal Financial Market Service) 31 March 2000 N ИК-04/1608 (О "невозможности участия юридических лиц в совете директоров АО в качестве его членов" см. письмо ФКЦБ РФ от 31 марта 2000 г. N ИК-04/1608).

¹³⁶ "Руководство текущей деятельностью"; "ledelse av den løpende virksomheten".

¹³⁷ Molotnikov, p. 185.

¹³⁸ Black, Kraakman and Tarassovan, p. 394 enlist the alternatives in the JSC Act as: CEO, CEB and managing company. The temporary executive body has the author included due to point out the hiring and firing procedures.

3.4.3.1 *Single general director (CEO)*

This is the most widespread formation of the executive body in Russia, and it is formed on the basis of the JSC Act article 69 and the LLC Act article 40. The legal relationship between the CEO (as a single physical person) and the company is labor contractual, which is regulated by the Labor Code in addition to the Acts on JSC and LLC.

3.4.3.2 *The managing company*

Under Russian law, the power of the executive body may be transferred to another legal entity, namely the managing company, on the basis of a contract by the GM's decision (the Civil Code article 103, the Act on JSC article 69 and the Act on LLC article 42). This possibility is provided for in both the UK and U.S., but in Norway and Germany this is a rather unknown arrangement.¹³⁹ The managing company acts in the name of and on the account of the company, according to article 53 in the Civil Code.

This construction is mostly used by holding companies with several subsidiaries in order to exercise efficient administrative control.¹⁴⁰ Moreover, the managing company usually takes form as an individual company.¹⁴¹ The relationship between the companies is governed by a civil contract. The more specific legal nature of this contractual relationship (for instance, whether it is a *service contract* or *mixed contract*) is at issue in the Russian legal literature, which debates the different types of contract (as provided for in part two of the Civil Code) that regulates the relationship.¹⁴² The specific type of contract does not impact the liability regulations. All civil contracts with regard to liability are generally regulated in article 401 in the Civil Code, in addition to the special liability bases provided for by different types of violations (see further section 6 and 7 and especially section 7.9).

¹³⁹ Black, et al, pp. 139-141.

¹⁴⁰ P. 348 in Shitkina I S, *Corporate Act* (Корпоративное право), Moscow, Wolters Kluwer, 2007 (hereinafter, Shitkina).

¹⁴¹ Ivanov 1999, p. 1.

¹⁴² An example of this discussion may be seen in Molotnikov, p. 190 and Black, et al, pp. 135-136.

3.4.3.3 The temporary executive body

A temporary executive body is also listed as one of the formations of the executive bodies in article 69, section 4, subsection 4, in the Act on JSC. The practical function of this body relates to situations where the BD has fired the executive and the subsequent hiring of a new permanent executive remains open for approval by the GM. This is in reference to a scenario in which the articles of association do not confer the competence of hiring the executive body to the BD. In LLC, this body is not accounted for, as the hiring and firing of the CEO is under the exclusive competence of the GM. This implies that the participants must be summoned for an extraordinary GM in order to first fire the executive and then hire a new one.

3.4.3.4 The collective executive body (CEB)

This can be formed on the basis of the JSC Act article 70 and the LLC Act article 41. In LLC, it is the GM that elects the member of this body. The chairman of this body is also acting as the CEO. If members of the CEB are supposed to be members of a BD, as well, this is constrained by the JSC Act article 66, section 2, which stipulates that members of the CEB can only constitute one quarter of the BD. The CEO cannot chair the BD. The LLC Act has no equivalent regulation regarding the restraints on members in the BD and does not regulate who can chair it.

The competence of the facultative CEB is to be determined by the GM, according to the Act on JSC article 41, section 1 and the LLC Act article 48, section 1, subsection 8. The CEO will perform as chairman in the CEB, if it is formed. The construction of the CEB is usually employed to limit the power of the CEO.¹⁴³ The delimitation of competence between the CEB and the CEO is obliged to be regulated in the articles of association and other internal documents that are confirmed by the GM, according to the Acts on JSC and LLC, article 42, section 2 and article 70, section 1. It should be noted in this regard that every member bears his own liability. Hence, there is no collective liability for the executive body. This applies to the members of the BD, as well.

For further reading, the reader should take note (see. section 1.4) that the main focus of this thesis is the CEO. As such, the liability for the members of the CEB will not be discussed. However, the standard of the liability will, in most cases, apply to these members as well.

¹⁴³ Shitkina, p. 355.

4 Types of claims in cases where the executive has caused damage to the company and/or its shareholders

This section accounts for the different types of claims for damages, regardless of the legal basis, that may be filed against the executive by the shareholders and/or the company.¹⁴⁴

4.1 The company's direct claim against the Executive

The Russian legislation provides for a range of various legal liability bases that apply to different situations where the executive may become liable vis-à-vis the company. The main and most widely applicable liability bases, with regard to the executive, are the JSC Act article 71 and the LLC Act article 44, section 5, which are the main focus of this thesis.

It should be noted that article 71 provides for two different liability bases. It is the general liability base that can be compared to article 44 in the LLC Act and there is a special and narrower base in article 71, section 2, subsection 2, which only applies in certain situations. The latter is treated in sections 4.3 and 8.2. Hereinafter, any reference to articles 71 and 44 excludes the specific liability base in article 71, section 2, subsection 2.

4.2 Shareholder's indirect claim

Article 71, section 5 in the JSC Act and article 44, section 5 in the LLC Act, provide the *shareholders* with a right to file an “indirect lawsuit” against the executive in case of a violation of articles 71 and 44 vis-à-vis the company.¹⁴⁵ In JSC, the stockholder¹⁴⁶ must own more than 1% of the

¹⁴⁴ For a definition of shareholders' and companies “direct claim”, cf. n 37.

¹⁴⁵ In the literature, this is referred to as “indirect lawsuit” (Косвенный иск). E.g. p. 52 in Yarkov V, *Indirect Lawsuit: Theoretical and Practical Problems* (Косвенные иски: проблемы теории и практики), in: Corporate Lawyer (Корпоративный юрист), no. 11, pp. 52-58, 2007 (hereinafter, Yarkov). Black, et al, pp. 168 et seq, apply the term “derivate suit”. A “derivate suit” is a “legal action in which a shareholder of a corporation sues in the name of the corporation to enforce or defend a legal right because the corporation itself refuses to sue” (<http://legal-dictionary.thefreedictionary.com/Stockholder's+Derivative+Suit>). This is, however, not an entire precise description of the legal concept of indirect suit as a matter of Russian law. This is due to the fact that it is not clarified under Russian law whether a shareholder can sue the manager *in name of the company* (see section 5.3.1). So far, the court has accepted the shareholder in the indirect lawsuit, and, if the claim is affirmed, granted the award to the company, without specifying formally this question.

¹⁴⁶ See definition of this term in n 36.

equity or common stocks in order to commence this action. The purpose of this remedy is to provide a means for shareholders to protect the interests of the company. This remedy is typically relevant in cases when a major shareholder protects the present or former executive, which even may be himself, or because the shareholder(s) wants to commence court procedures without waiting for a decision by the general meeting (GM). It is the shareholder(s) that may file a claim for damages against the executive, according to the wording of this provision. Thus, the shareholder will file the lawsuit in his own name, but it is the company that will, in case of approbation, be awarded the amount of damages (see further section 5.3.1). This is because it is the *company's loss* that is claimed. A restoration of the company's loss is, naturally, indirectly favorable for the shareholders.

As previously mentioned, the main focus of this thesis is the company's direct claim and the shareholder's indirect claim (sections 4.1 and 4.2), each of which are further discussed in sections 5, 6 and 7. The following types of claims are beyond the scope of this thesis and are only described below to provide an overview. Section 4.3 treats two special liability bases that are respectively commented upon in sections 8.2 and 8.5. Section 4.4 will not be discussed in any further detail (cf. section 1.4).

4.3 Stockholder's (and company's) direct claim in certain situations

The only place the law directly provides a shareholder with a right to claim damages against the executive for restoring his own personal losses (without any relations to the company) is in article 71, section 2, subsection 2 in the JSC Act and in the Federal Act on the "Security Market" article 22.1.¹⁴⁷

In case of a violation of the provisions in part XI.1 in the JSC Act, article 71, section 2, subsection 2 provides the stockholders with the right to file a lawsuit against the executive. Part XI.1 concerns the regulation on the procedures when a stockholder acquires more than 30% of the stocks. This liability rule also provide a special liability base for the company against the executive, in contrast to the Act on the "Security Market" article 22.1, which only provides the stockholders with this right. The liability in the latter provision applies when information provided in prospectus due to an issue of stocks or securities is incorrect, which in turn leads to a loss for the stockholder.

¹⁴⁷ Federal Act on the "Security Market" of 22 April 1996 (Федеральный закон от 22 апреля 1996 г. N 39-ФЗ "О рынке ценных бумаг").

4.4 Shareholders' direct non-contractual claim against the Company and/or executive

The shareholder is not formally a part of the contractual relationship between the company and the executive. Thus, as an alternative means of achieving compensation for losses other than that which was previously mentioned, the shareholder may base his claim on non-contractual liability for damages based on the Civil Code articles 1064 (general basis for non-contractual claims) and/or 1068 (the employer's liability for its staff) against the company. Such a lawsuit should be filed after he has sold the shares (in order to avoid reduction in share value as a result of the lawsuit). However, this remedy is, insofar the author has been able to reveal, not yet applied or properly discussed in theory or practice in Russia.

By comparison, under Norwegian law, it is a general company law principle that claims from the shareholders against the company are not permitted. This is to protect the company's creditors. Such a principle is unknown under Russian law.

5 Initiating the claim, preconditions for prosecution of the claim and procedural problems

Besides the material questions of awarding a claim for damages, there are several procedural questions of a different nature that may hamper the approbation of a claim for damages against the executive. First, there are preconditions that must be satisfied in order to initiate the hearing. Second, there are particular features of the procedural regulation that may prevent a proper approbation of a claim. In addition, there is a problem with the enforcement of an affirmed claim. These questions are discussed below.

5.1 Limitation period

The general limitation period for filing a lawsuit is three years after the infringement on the civil right, according to article 196 in the chapter of limitation periods in the Civil Code. That is, three years since the wrongful act took place. Special limitation periods run in some instances, according to article 197, but these do not apply to liability cases.¹⁴⁸ Filing a lawsuit prevents the statute of limitations from running (article 202).

5.2 Company's claim against the executive

The decision to take legal action is generally embedded in the competence of the executive, since as he represents the company (according to the Acts on JSC and LLC, article 69, last section and article 40, section 3, number 1). This is not the case, however, if this competence is assigned to other bodies by the articles of association.¹⁴⁹ Since the executive is unlikely to initiate a suit against him, the only means of pursuing the claim is to fire the executive and get a new one to prosecute the claim. Another option is to assign the competence of taking legal action to another body. The general meeting (GM) may seize the power of the executive and transfer this competence to the board of directors (BD), according to the Acts on JSC article 69, section 4 and on LLC article 33,

¹⁴⁸ Sadikov to article 197; Commentaries to article 197 in Abovoy M M, et al, *Commentaries to the Civil Code RF* (Комментарий к Гражданскому кодексу РФ), Yurayt - Publishers (Юрайт-Издат), 2005 (hereinafter, Abovoy).

¹⁴⁹ See e.g. p. 229, et seq in Dobrovolskiy V I, *Protection of Corporate Property in the Arbitrazhnyy Court* (Защита корпоративной собственности в арбитражном суде), Moscow, Wolters Kluwer, 2006 (hereinafter, Dobrovolskiy).

sections 4 and 5. When the competent body of the company is taking legal action, the litigation procedure is subordinated to the ordinary procedural regulation, as it is set forth by the APC or CPC.

5.3 Proceeding with an indirect lawsuit by the shareholder – procedural problems

According to the Act on JSC article 71, section 5, stockholders¹⁵⁰ have to hold at least 1% of the company's common shares in order to file an indirect claim for damages. The LLC Act article 44, section 5 states that any participant,¹⁵¹ regardless of the size of his part¹⁵² in the company, may file a claim for damages. This is the starting point for commencing an indirect lawsuit. However, further details on the indirect lawsuit have not been specified in the two Acts and are subject for considerable debate in Russian legal literature.¹⁵³ These procedural problems are discussed in this section.

In comparison, under Norwegian law, the shareholders are provided with a right to file an indirect claim for damages in name of the company if they are holding at least 10% of the shares, pursuant to articles 17-4 in the JSC Act and LLC Act (most of the articles run in parallel throughout the two Acts). A precondition is that a proposal to claim damages against the executive on the same grounds has already been rejected by the GM, according to articles 17-4.

The stance in other jurisdictions shows that it is rather difficult for a shareholder to file an indirect suit. Thus, procedural problems or cumbersome processes in relation to the indirect lawsuit are not unique to Russia. For instance, in Germany a set of preconditions have to be met. For instance, the shareholder must show that he became a shareholder before learning about the damage incurred by the company, that he demanded that the company take legal steps before commencing the indirect suit, that there are grounds for the court to believe that the company incurred damage because of dishonesty, and that enforcement would not be contrary to the company's interests.¹⁵⁴ In the UK, the circumstances that allow for an indirect lawsuit are so "difficult that the derivate action is virtually

¹⁵⁰ See definition of this term in n 36.

¹⁵¹ See definition of this term in n 36.

¹⁵² See definition of this term in n 127.

¹⁵³ Dobrovolskiy, p. 168.

¹⁵⁴ Black, et al, pp. 175-176.

non-existent in England”.¹⁵⁵ The United States has also complicated procedural rules governing a suit brought by the shareholders.¹⁵⁶

5.3.1 The problem of not involving the company and obtaining evidence

The company may take common legal actions together with the shareholder, pursuant to article 46 in the APC and article 40 in the CPC. The problem arises, however, if the company refuses to participate in the lawsuit against the executive.¹⁵⁷ Not involving the company makes it significantly more difficult to obtain all necessary documentation in order to elucidate the grounds for the claim before the courts.¹⁵⁸ One example of a problem is the difficulty of obtaining necessary documentation from the company’s bank, since such documentation is protected from inspection by a third party. Generally, a major problem arises in all situations involving the need to reveal legally protected corporate secrets and internal documents.¹⁵⁹ On the other hand, if the executive in question is still serving as the executive, he will be the one appearing in court if the company becomes involved in the procedure, and it is doubtful whether that will remedy the case.¹⁶⁰

The legal status of the shareholder filing the lawsuit and the legal status of the company under the court procedure of an indirect lawsuit are not clearly regulated for in the law. This problem is a matter of discussion in the legal literature.¹⁶¹ For instance, one proposition is to bring the company into court procedure as so-called third person, pursuant to article 51 in APC and article 43 in CPC. However, it is not clear whether this would be the correct way to bring the company to court.¹⁶² The court cannot force the company to hold the status of a claimant, pursuant to articles 44-46 APC and article 38 CPC.¹⁶³

¹⁵⁵ Ibid, p. 179.

¹⁵⁶ Ibid, p. 181.

¹⁵⁷ Dobrovolskiy, p. 230.

¹⁵⁸ Dobrovolskiy, p. 232.

¹⁵⁹ Yarkov, p. 57.

¹⁶⁰ Dobrovolskiy, p. 232.

¹⁶¹ Black, et al, p. 168.

¹⁶² See more details in Yarkov, p. 55 et seq, referring to some cases where the company had been brought into the procedure according to article 46 APC, and in other cases where the court had refused to apply article 46 to bring the company into the case; According to cases reviewed by the author, there were several in which the company was brought into the case as a third person. See e.g. Resolution SAC of 22 May 2007 N 871/07.

¹⁶³ Black et al, p. 230. Here it is briefly discussed the problems of how to involve the company in the said type of cases; These articles state, inter alia, the voluntariness of filing lawsuits in general, thus one cannot enforce someone to make a claim.

Moreover, despite the fact that the literature in recent years tends to conclude that the shareholder in indirect lawsuits performs as a sort of representative in the name of the company,¹⁶⁴ this does not provide him with any further rights to obtain necessary information from the company. Thus, the shareholder may only obtain information in his capacity as a shareholder or plead for applying the general procedural provisions to obtain evidence. When it comes to the shareholder position, for example, a stockholder must hold more than 25% of the stock¹⁶⁵ in order to request full presentation of the protocol of the collegial executive body (CEB) (if formed) and the bookkeeping, pursuant to article 91, section 1. More importantly, all other company information listed in article 89 (the article lists various company documents like protocols, accounts etc, but does not list that type of documents that will be recognized as typical confidential, like internal correspondence, strategy documents, contracts etc.) is legally available to the stockholder. Obtaining information is slightly easier for a participant in an LLC, as article 8 in the Act on LLC provides full access to all information about the company. When it comes to applying the general procedural provisions on obtainment of evidences as a party to litigation, the party has certain procedural rights for obtaining evidence. Most practical are article 72 in APC and article 64 in CPC, which concern the securing of evidence upon request of a party member. Although the shareholder has these procedural rights that are derived from being a party to litigation, it is doubtful it provides sufficient access to the information needed for an approbation of the claim, considering the factual obstacles that the executive may use to block such information. In addition, the court's thresholds to apply article 72 in the APC and article 64 in CPC are high.

Moreover, because of both the focus on written evidence in Russian legal tradition when it comes to the assessment of evidence and the high thresholds for proving the material conditions in a claim for damages against executives,¹⁶⁶ approbation requires extensive documentation from the claimant (see section 7.5). Some of this may be remedied if the executive has already left his position and the new executive is more inclined to help the claimant with presenting information. Under Norwegian law, the court may establish the burden of proof for specific circumstances with the person that is the best able to reveal the information. Unfortunately, such a rule is unknown under Russian law.

¹⁶⁴ Yarkov, p. 56; See e.g. FAC Moscow District of 16 March 2006 no KG-A40/1768-06-P.

¹⁶⁵ See definition of this term in n 127.

¹⁶⁶ Burnham, Maggs and Danilenko, p. 389; P. 7 in Efeev B S, *The problems of proving causality between non-fulfillment of contract and losses* (Проблема доказывания причинной связи между неисполнением договора и убытками), in: "Legislation" (Законодательство), no. 12, 2005 (hereinafter, Efeev).

If the losses and wrongdoing of the executive refer to deals that he has entered in the name of the company, it may be more appropriate in many cases to claim invalidation of these deals, instead of claiming damages. The conditions of getting the deal invalidated are more clear-cut and do not impose assessments of vague standards, as the “negligent assessment” under the liability assessment. Legal bases for invalidation may be found in several areas of the legislation, such as the regulations on “personal interest” (see section 8.3) and “major transactions” (see section 7.7.5.2).¹⁶⁷ Furthermore, Civil Code articles 170 (pro forma contracts), 168 (contracts in conflict with legal provisions) and 178 (invalidation of contracts when exceeding one’s competence) provide a base for invalidation. The Civil Code articles are general and do not deal specifically with company relations.

5.3.2 Who sustains legal expenses

Article 110 APC and article 102 CPC state that the losing party in the case must cover the litigation expenses of the winning party. If a claim is partly sustained, the expenses are paid in proportion to the degree to which the claim was sustained, according to APC articles 110-111 and CPC article 98. In this manner, the shareholder will not sustain losses if their claim is affirmed. If the shareholder loses, he must cover the court costs.¹⁶⁸ If one sees the shareholder as a representative of the company, the company will be responsible for the loss. However, there have been various approaches to this matter so the law remains unsettled.¹⁶⁹

5.3.3 Enforcement of an abbreviated claim for damages

Another factual problem is the enforcement of the claim once it is affirmed. The Act on Enforcement Proceedings,¹⁷⁰ article 29, section 2 yields the right to enforce a judicial decision to the person the decision is made in favor or interest of. In an indirect lawsuit, the decision is made in interest and in favor of the company. The executive is entitled to take actions on the basis of court

¹⁶⁷ Russian law uses the term “Заинтересованность”, which is translated to “personal interest” in English (in Norwegian: “interessekonflikt”). This refers to situations where there is a conflict of interest, thus, the term “conflict of interests” might be a more suitable *legal translation* of the concept and a more widely known legal term under Anglo-American jurisdictions. However, in this thesis the linguistically more correct translation “personal interest” is applied.

¹⁶⁸ Osipenko, p. 475; Yarkov, p. 58.

¹⁶⁹ Black, et al, pp. 170-172 discuss the question on compensation for legal expenses, noting upon that recently have judicial decisions tended to see the shareholder as a representative, and thus, made the company responsible for the costs.

¹⁷⁰ Federal Act on “Enforcement Proceedings” of 21st of July 1997 N 119-F3 ”Федеральный закон от 21 июля 1997 N 119-ФЗ ”Об исполнительном производстве”

decisions and to enforce them, as the executive represents the company. This may lead to a serious problem if the executive is the defendant in the case and he remains in position, as it is unlikely that he will enforce the claim against himself. There are several real-life incidences where an investor has gained a favorable court ruling but the executive remained in power and the decision of the court was not enforced.¹⁷¹

5.3.4 Indirect lawsuit against the managing company

A shareholder may sue the managing company on the basis of articles 71 or 44 if he controls more than 1% of the common shares. The shareholder of the managed company cannot, however, directly sue the CEO¹⁷² of the managing company. The shareholder can only sue the managing company as such, except if the shareholder happens to be a shareholder in the managing company, as well.¹⁷³

5.3.5 Conclusion

When examining procedural problems with regard to the indirect lawsuit, several issues stand out and should be clarified by the legislature. First, Russia, in contrast to most western countries, has failed to define the status of the shareholder and the company (and their mutual procedural relation in court as well) in an indirect lawsuit, causing unnecessary practical problems. Moreover, it should clarify how the company is supposed to be represented in an indirect lawsuit.

Furthermore, it should be provided a right to obtain classified documents and other evidence from the company on behalf of the shareholder.

Finally, shareholders should be provided with a procedural remedy to ensure the enforcement of an approbated claim for damages against the executive.¹⁷⁴ It is not acceptable that it is up to the executive himself, if he still is in position, to enforce the claim.

Clarifications on these issues would be important steps to secure the interests of the investors and minority shareholders.

¹⁷¹ Wolk, p. 238.

¹⁷² See definition of this term in n 11.

¹⁷³ See more of this discussion in Black, et al, p. 137, with further references to Russian literature on this matter.

¹⁷⁴ See eg Black, et al, 171 and Yarkov, p. 48, recommending the same amendment.

5.4 Which court has jurisdiction?

5.4.1 The problem of overlapping jurisdictions

The jurisdictions of the Court with General Jurisdiction (GC) and the Arbitrazhnyi Court (AC) are defined in the CPS article 22, and articles 1 and 27-33 in the APC. In addition to the general objective in article 1 in the APC, which states that AC is dealing with conflicts in the sphere of business, article 33 states that conflicts between shareholders and the company are regulated by the APC, with the exception of labor conflicts. Article 22 in the CPS is much more general and encompasses labor conflicts. Due to the fact that the relationship between the CEO and the company is also a labor relationship, problems have arisen in court as a claim for damages against the executive in principle can be included under both jurisdictions.¹⁷⁵ In the instance of the managing company, as a commercial organization with no labor contract with the company, it is clearly under the jurisdiction of AC.¹⁷⁶

The CEO's breach of his obligations may be viewed as a breach of the labor contractual relationship between the CEO and the company, and thus may be under jurisdiction of the GC. On the other side, the relationship may be viewed as a company relationship and thus fall under jurisdiction of the AC. According to the Supreme Arbitrazhnyi Court (SAC) Resolution 18 November 2003, no. 19, item 38, a shareholder commencing court procedures in the form of an indirect lawsuit against the executive on the basis of article 71 in the JSC Act is generally under the AC's jurisdiction. The Resolution does not touch on the situation when *the company* is commencing legal actions by itself against the (former) executive.¹⁷⁷ The Supreme Court (SC) Resolution 20 March 2003, no. 17, states that GC has jurisdiction over conflicts between managers¹⁷⁸ and the company only if the basis of the conflict is a violation of the Labor Code. According to the SC Resolution 24 March 2004, no. 27, however, a company commencing court procedures against its former executive must address the claim to the GC, as this is a labor relationship. Apparently, the latter Resolution contradicts the first two. Deducing from these Resolutions, at the very least the indirect lawsuit will be under the exclusive jurisdiction of the AC.¹⁷⁹ If the executive is also a shareholder, then the case will be under

¹⁷⁵ See eg Black, et al, p. 169.

¹⁷⁶ Ibid, p. 55.

¹⁷⁷ See eg Dobrovolskiy, p. 237, discusses the possible contradiction between the two jurisdictions. He concludes with calling for the legislator to specify and clarify the delimitation between the jurisdictions of the two courts.

¹⁷⁸ See definition of this term in n 10.

¹⁷⁹ See e.g. also two rulings by FAC Moscow District 31 May 2005, no KG-A40/4395-05 and FAC Moscow District 20 July 2004, no KG-A40/6009-04 that support this view. See also Black, et al, p. 169

the jurisdiction of the AC as well, as this directly follows from article 33 in APC.¹⁸⁰ More uncertain is the situation with regard to a conflict between the executive and the company, as it can be asserted that this is in principle a labor relationship.¹⁸¹ Nevertheless, court practice shows that if a lawsuit in the first place is filed with the AC, it remains in the AC system and appellate AC courts do not rectify lower instances on the grounds of improper jurisdiction. Almost all of the cases found and examined by the author and cases referred to in the legal literature have been AC cases, regardless of the referred court practice and discrepancy.¹⁸² For instance, a judgment by Regional Federal Arbitrazhnyi Court (FAC) North-Caucasian District, 18 January 2007, no F08-6826/2006, referring to the SC Resolution 20 March 2003, no. 17 (not commenting upon, albeit, the SC Resolution of 2004), heard a case between the company and its former CEO and stated that the GC only had jurisdiction where the claim was based on a violation of the Labor Code.¹⁸³ Several similar cases filed with the AC have it accepted for decision, but leaving alone the discussion of a possible improper jurisdiction with regard to GC.¹⁸⁴ In this way, the most likely conclusion is that GC will only have jurisdiction in cases where the claim is based purely on a violation of the Labor Code and, for instance, not on articles 71 or 44 in the Acts on JSC and LLC. Furthermore, judging upon the court practice and taking into account that most cases are filed with AC, SC Resolution 20 March 2003, no. 17, is the closest to clarify the issue of delimitation of the jurisdictions. This implies that the AC has jurisdiction in all cases where the claimant bases his claim against the executive on the company legislation, for instance article 71 in the JSC Act, and not on the regulations in the Labor Code. This is appropriate due to the fact that the AC court has more competence on business matters. Moreover, this approach is more harmonious with article 1 in the APC.¹⁸⁵ In particular, the risk of overlapping jurisdiction is a divergence of practice on the same questions between the two courts. For these reasons, both the AC and SAC should develop a joint resolution to clarify this matter. Otherwise, the legislature will need to find a remedy.¹⁸⁶

¹⁸⁰ Dobrovolskiy, p. 55.

¹⁸¹ Black, et al, pp. 169-170.

¹⁸² Searches that was conducted in the Konsultant database, give roughly 5 AC cases for every 1 SC case on liability for the executive body. Cf. n 20.

¹⁸³ The same is stated in the case of FAC North-Caucasian District, 27 May 2003, no F08-1555/2003. The case is also used as an example by Dobrovolskiy, p. 239. Furthermore, the same is stated in FAC Ural district 27 Mai 2007, no F09-4914/07-C4

¹⁸⁴ See e.g., two rulings made by FAC North-Siberian District of 14 February 2008 no A19-11027/07-F02-218/18 and of 15 January 2008, no A33-5399/07-F02-9722/07.; See e.g. the ruling by the FAC North-Caucasian District, 27 May 2003, no F08-1555/2003.

¹⁸⁵ Yarkov, p. 55; see n 73 for a reference to article 1.

¹⁸⁶ Dobrovolskiy, p. 237 and Black, et al, p. 170, recommending clarification on this matter.

6 The material conditions for awarding damages under Russian law

The material conditions that must be satisfied in order to be awarded damages from the executive are rather complicated. Most legislatures provide for different types of liability, like fault-based, strict liability and others. Under Russian and Norwegian law, the liability for managers¹⁸⁷ is fault-based. As such, the focus in this thesis is fault-based liability. Despite the fact that the outlines of the fault-based liability conditions under Russian law are quite similar to those under Norwegian law, there are features that will seem awkward to a Norwegian or another Western lawyer. This is partly due to shortcomings in the ongoing determination of this sphere of law. In order to frame the analysis, the Norwegian approach to fault-based liability is accounted for first, and then it is followed the Russian approach.

6.1 Norwegian law on fault-based liability

Under Norwegian law, the standard and default legal basis for claims for damages in contracts, as well as outside of contracts, is fault-based. The rule is based on custom. Some Norwegian legal acts have, however, codified this rule in specific legal areas. Subsequently, these codified provisions serve as the legal basis for liability within their range of application. An example of such codification in a relationship outside of contract is the Act on Intellectual Property,¹⁸⁸ article 55, which refers to fault-based liability when exploiting another's intellectual property. A codification implies that the legal basis occasionally overlaps custom, and in this way the custom elaborates the content of the codified rule. An example of such codification in contract is articles 17-1 in the Norwegian Acts on LLC ("aksjeselskapsloven") and Act on JSC ("allmennaksjeselskapsloven"), which impose fault-based liability for company managers.

In contract law, it may vary, depending on the type of contract and its regulation and the contract's conditions, whether the legal base is a fault-based one; whether it is

¹⁸⁷ See definition of this term in n 10.

¹⁸⁸ "Lov om opphavsrett til åndsverk m.v." (Act on Intellectual Property) of 5/12, 1961 nr 2.

strict liability; whether it is strict liability with exceptions for force majeure; or whether it is the so-called control-liability.¹⁸⁹

The control liability has become the most common liability rule when it comes to contracts of generic performance (see, for instance, the Sale of Goods Act,¹⁹⁰ article 57). Control-liability was introduced in Norwegian legislation with the compilations of UNIDROIT, PECL and CISG, and it has replaced the strict liability with exceptions of force majeure in several Norwegian acts that regulate different contract types. Strict liability has a limited range in contractual relations and applies to the situations where the defendant has a defective title, he has offered guarantees for his performance, or he is short of the money that the contract obliges him to pay. The fault-based liability is acknowledged as a universal liability rule and may be claimed in all contractual relationships. However, the control liability, strict liability, or strict liability with exceptions of force majeure, is the most advantageous type of liability to base a claim for damages upon for the sufferer, as in the fault-based liability type the sufferer must prove the negligence of the wrongdoer. A combination of contractual strict liability and non-contractual fault-based liability is the so-called employer's liability for his employees. This implies that if the employee negligently causes damages to a third party in the capacity of being employee, this makes the employer strictly liable vis-à-vis the third party.

The Norwegian fault-based liability depends generally on three conditions, whether inside or outside contract. If these are satisfied, the claim for damages may be awarded. The conditions originate from custom. First, a negligent act must be present. It is the claimant that should prove, as the main rule, the negligence. Secondly, there must be an economic loss. The third condition is that the wrongful act must be a proximate cause to the loss.

Whether the act was negligent is due to an overall and concrete assessment. In contractual relationships, the breach of contract is not vital for the approbation of a fault based claim for damages. On the one hand, a breach would strongly indicate that negligence was present, but on the other hand, the absence of it does not preclude liability.

¹⁸⁹ See Craig under the term "kontrollansvar" for further explanation of the term control liability; In most types of contracts (except most service contracts, e.g. contracts with company managers) a concrete breach of contract will be subjected to strict liability with exceptions of force majeure or control liability, leaving the fault-based liability not so interesting for the sufferer.

¹⁹⁰ "Lov om kjøp" (The Sale of Goods Act) of 13/5, 1985 nr 27.

The negligence condition depends on the assessment of whether or not the defendant acted according to the “culpa standard”. Traditionally, under Norwegian law, the assessment of negligence consists of two assessments. The first is the wrongful act, or objective element of negligence assessment, which addresses whether a written or unwritten legal norm has been violated (typical a contractual provision or statutory law). The second is the subjective element, which is the assessment of the wrongdoer’s psychological comprehension of the wrongdoing. Today, a bit simplified, one might say that these elements are merged into one overall assessment. The negligence assessment is currently acknowledged as being based on the “objective” conduct of the wrongdoer, and whether he could and should have acted differently.¹⁹¹ In some situations, however, more explicit and distinct assessments of the wrongful act and the subjective element are fruitful. This is especially the case when assessing manager’s liability in company relations.¹⁹² As apparent below, such distinct assessments resemble the Russian approach.

6.2 Russian law on fault-based liability

In Russia, there is no customary law that can serve as legal basis for liability, since custom is not formally recognized as a source of law (cf. section 2.4). Thus, all claims for damages must be claimed on the basis of a statutory provision (a liability basis), whether it is a claim originating from a contractual relationship or whether it stems from a non-contractual relationship. The general and default legal regulations of claims for damages are provided for in the Civil Code. The general and default type of liability is fault-based liability. This is set forth by articles 401 and 1064 in the Civil Code. Article 401 applies to all contracts, while article 1064 applies to non-contractual relationships. Article 401 is non-mandatory, and consequently it is possible to derogate from it if the contract states that the liability is to be another than the default fault-based liability. However, according to section 3 of article 401, a breach of contract that is committed by a commercial party in its capacity as such, its liability is not fault-based, but strict with the exception of force majeure. Section 3 is only relevant when assessing the liability for the managing company, as this is a commercial party (see section 7.9).

The conditions for affirming fault-based liability under Russian law do not differ extensively from the conditions for liability under Norwegian law. The conditions for damages are first, the presence of a wrongful act, second, the act has been committed negligently by the wrongdoer (see sections

¹⁹¹ Hagstrøm, p. 10.

¹⁹² Aarum, pp. 187-189.

6.2.1-6.2.3 for elaborations),¹⁹³ the third, the presence of an economic loss, and fourth, the wrongful act has to be a proximate cause of the loss. The conditions are generally recognized in legal literature and can be deduced from articles 401 and 53 in the Civil Code, as well as article 71 in the JSC Act and article 44 in the LLC Act.¹⁹⁴

Besides the aforementioned mentioned default liability provisions of the Civil Code, Russian civil legislation contains numerous special provisions regulating liability. Some of these are set out in separate federal acts while others are in the Civil Code.¹⁹⁵ The type of liability stated by the provision depends on its interpretation. For example, if the provision says nothing, it will be fault-based by default, due to article 401. The regulations in the Civil Code typically serve as general rules that supplement the special federal acts (cf. section 3.2). This somewhat resembles the situation in Norway in the way that customary rules supplement the content of the codified liability basis (see the former passage).

The relations between the general liability regulation in the Civil Code and the special liability bases imply that the latter cannot be interpreted in isolation, but must be interpreted in light of, and supplemented by, the general provisions of the Civil Code. In contractual relationships, this applies in particular with regard to article 401. With regard to company relations, article 53, section 3 in the Civil Code states liability for those who act in the name of a company, regardless of the type of company, if they were not acting reasonably or in good faith according to the interests of the company.¹⁹⁶ Thus, this article must be interpreted in light of, and supplemented by, the general rule of article 401, since the latter regulates all contractual relationships in general, and article 53 does not exclude the application of article 401. In this regard, an action that is not committed in good faith, reasonably and not in the interests of the company would constitute a wrongful act.

¹⁹³ For “negligence”, Russian law uses the word “вина”. In latin “culpa”, in English “negligence”, in German “schuld” and in Norwegian “skyld”.

¹⁹⁴ P. 598 in Sukhanov E A, *Civil Law* (Гражданское право) volume 1, 3rd edition, Moscow, Wolters Kluwer 2007 (hereinafter, Sukhanov); Black, et al, p. 11 delineate the elements of civil liability as economic loss, causality and the existence of culpable conduct. Such categorization does not, however, take into account wrongful act condition, which is unquestionably present in Russian civil liability. But it might be that the term “culpable conduct” is meant by the authors, to include the wrongful act assessment, as it is also under Norwegian law. Notwithstanding, the wrongful act condition should be recognized as separate condition as a matter of Russian law.

¹⁹⁵ Shitkina, p. 473.

¹⁹⁶ The Russian term “добросовестно” is translated to “good faith” (in Norwegian: “god tro”, [men begrepet er ikke helt sammenfallende med the norske juridiske konseptet “god tro” men bør oversettes som “samvittighetsfullt”]) while “разумно” is translated to reasonableness (“sensible”, “rational”, etc do also apply) (in Norwegian: “fornuftig”/ “rimelige”). The terms “reasonableness” and “good faith” are applied in Black, et al and Black, Kraakman and Tarassova as well.

Additionally, there is the condition of negligence, pursuant to article 401. Finally, there are the conditions of the presence of an *economic loss proximately caused* by the wrongful act. The same system applies to other special bases that are provided for in other federal acts. With regard to the executive, there will be a number of special legal bases in various federal acts. The most far reaching and general liability basis amongst the latter are article 71 of the JSC Act and article 44 of the LLC Act. The special legal bases in article 71 and article 44 must then be interpreted in accordance with article 401 and 53.¹⁹⁷ This is due to the fact that article 53 has the same scope as articles 71 and 44, and in this way, supplements the latter two articles. Since articles 71 and 44 name “negligence” as a condition for claiming damages and article 401 provides a definition of negligence, that definition applies to articles 71 and 44 as well. Some confusion may arise since the wording of the articles is identical in certain sections. For example, the duties or obligations of acting reasonably, in good faith and in the interest of the company in article 53 have almost the same wording as in articles 71 and 44. Additionally, article 53 does not provide anything supplementary to articles 71 and 44 besides covering additional company types that than the JSC and LLC). Such overlap may seem awkward, but the Civil Code articles are intended to be general and supplemental.¹⁹⁸ Thus, the claim for damages is based on the most special applicable legal base. If the claim for damages is based on a violation by an executive in a JSC for not acting reasonably, in good faith and in the interests of the company, the claimant should base the claim for damages on the liability basis in article 71 of the JSC Act.¹⁹⁹

The following provides a closer examination of these general conditions in a fault-based liability claim, as these supplement specific liability bases, like articles 71 and 44. However, the economic loss and proximate cause are only discussed in relation to articles 71 and 44, in sections 9 and 10. Some of the general viewpoints presented here will apply to other basis for liability, as well. In section 7, articles 71 and 44 will be discussed as a legal basis of liability for the executive body. In section 8, other legal basis will be touched upon to give the reader a clearer picture of questions concerning liability for executives.

¹⁹⁷ P. 3, in Makovskaya A A, *Basis and Size for Liability when Managers Cause Losses to the Company* (Основание и размер Ответственности руководителей акционерного общества за причиненные обществу убытки), in: Article Collection: Restoring Losses and its Practice (Rozhkova M A ed) (Убытки и практика их возмещения: Сборник статей), Statut, 2006 (hereinafter Makovskaya). The article discusses the relationship between article 401 and articles 71 and 44.

¹⁹⁸ It may be questioned whether it is apt to have general liability rules, especially concerning managers, in the Civil Code when the specific federal acts on different types of legal entities also contains such provisions.

¹⁹⁹ In many of the cases that were reviewed by the author, the claimant based his claim on both article 53 and 71 or 44, which did not provoke any comments from the court.

6.2.1 Wrongful act

A condition for being liable is that the defendant acted wrongfully. Article 401, section 1, stipulates that if one does not act in accordance with his obligation, then he becomes liable.²⁰⁰ A wrongful act or breach of one's obligations is a violation of legal norms in the form of statutory law, contractual provisions or the breach of more abstract legal norms, which is "contrary to the sense of justice".²⁰¹

With regard to the executive, such obligations may be derived from the legislation and the contract. First, there are compulsory and facultative provisions in federal and regional acts, such as tax regulations or other public legislation that the executive is responsible for complying with on behalf of the company. Second, there are contractual provisions stipulated in the labor contract, which is the commercial contract of the executive body in a managing company, and adherent legal norms like internal company documents such as the articles of association, instructions from the board of directors (BD) and the memorandum of association.²⁰²

In order to claim damages, there must be a liability basis that stipulates liability for the wrongful act in question. For example, these special legal bases *stipulate* certain obligations, of which, a breach would constitute a wrongful act. Far-reaching obligations are stipulated in articles 71 and 44. Another example of a special liability basis is article 11 in the "Act on Commercial Secrets", which indicates liability if a commercial secret is exposed by a manager (see section 8.1.6 for a discussion of this liability base).

6.2.2 Negligence

In order to be liable, the wrongful act must have been committed negligently. Article 401, section 1, in the Civil Code states that if one does "not act in accordance with one's obligations; he becomes liable by presence of negligence".²⁰³ The article provides a general characterization and interpretation of the negligent condition by negatively defining it as the following: "a person is not

²⁰⁰ "Лицо, не исполнившее обязательства либо исполнившее его ненадлежащим образом, несет ответственность (...)"

²⁰¹ Sukhanov, p. 600.

²⁰² Article 69, section 3, subsection 2 in the JSC Act lists similar obligations to comply with for the executive.

²⁰³ "Лицо, не исполнившее обязательства либо исполнившее его ненадлежащим образом, несет ответственность при наличии вины"

negligent, if the proper degree of “care”²⁰⁴ and “diligence”²⁰⁵ that was expected of him due to the character of the contract and the business conditions was present, and he undertook all necessary measures for ensuring a proper fulfillment of the contract.²⁰⁶ “Negligence”, in article 401, includes the simple negligence standard, gross negligence and intention.²⁰⁷

As a matter of Russian law, an objective conception of negligence is applied.²⁰⁸ This conception depends on whether or not the defendant’s conduct corresponds to an objective negligent action, regardless of his internal or subjective comprehension of the conduct. As Sergeeva states, “the internal approach may only be judged upon examination of his actions and whether the requisite carefulness and diligence are absent”.²⁰⁹ Sykhanov states that the actions of the defendant are not to be compared to an abstract “bonus pater” person, but to “the concrete circumstances, including the character of the obligations that he is incumbent with and the conditions of business,”²¹⁰ wherein the requirements of care and diligence have their source.²¹¹

6.2.3 Economic loss and causality

The sufferer must present an economic loss to be considered a claimant. There are general and default provisions in the Civil Code that regulate economic losses that apply to all bases of liability when nothing else is stipulated, namely article 15 and, if the liability originates from a contractual relationship, article 393.

²⁰⁴ “заботливость”. “omsorg”.

²⁰⁵ “осмотрительность”. Black, et al, p. 11 apply the translation “discretion” (in Norwegian: “varsomhet”/“skjønnsomhet”/“oppmerksomhet”).

²⁰⁶ “Лицо признается невиновным, если при той степени заботливости и осмотрительности, какая от него требовалась по характеру обязательства и условиям оборота, оно приняло все меры для надлежащего исполнения обязательства.”

²⁰⁷ The article only states negligence, but it is generally acknowledged that negligence refers to both gross and simple negligence. See e.g. Sadikov, to article 401.

²⁰⁸ See e.g. Sukhanov, p. 608 and Telyokina’s commentary to article 71, in Telyokina M V, *Commentaries to the Federal Act on “Joint Stock Companies”* (Федеральный закон от 26 декабря 1995 г. N 208-ФЗ “Об акционерных обществах”), Moscow, Wolters Kluwer 2005 (this book is provided by Garant database, which did not provide pagination for this book, therefore only articles are referred to here); Traditionally under Russian law, two different approaches existed in order to state negligence. First, there is the classic subjective approach in the criminal law, where to the negligence is to be judged on the defendant’s subjective and psychological comprehension of his actions and the consequences of his actions. Second, there is the objective approach, which does not consider the defendant’s subjective relations to his actions, only his conduct. See further in e.g. Makovskaya, pp. 9-10.

²⁰⁹ Pp. 674-675, in Seergev Yu K, et al., *Civil Act: Textbook* (Гражданское право: Учебник) vol 1, 6th edition, Moscow, TK Velbi (ТК Велби) Publishing House, 2002 (hereinafter, Sergeeva).

²¹⁰ “условы оборота” literally, this is translated with “conditions for turnover”. A more apt translation is “conditions of business”. According to various dictionaries, there are several slightly different translations involving these words in combination, e.g. “business custom”; “vilkår for omsetning” (literally).

²¹¹ Sukhanov, p. 608.

A closer definition of the “cause” condition is not provided for in the Civil Code, but is a generally acknowledged condition (see section 10). The conditions may as well be deduced from the special liability bases. For instance, articles 71 and 44 state that the executive “bears liability vis-à-vis the company for losses *caused* by the negligent action [author’s *italic*]”.²¹² The proximity assessment depends on the concrete assessment by the court.

²¹² “несут ответственность перед обществом за убытки, причиненные обществу их виновными действиями”.

7 Claims for damages based of articles 71 and 44

7.1 Introduction to the articles

In this section, the liability bases in articles 71 and 44 are discussed. The focus is on the obligations these articles stipulate. A violation of these constitutes a wrongful act. Furthermore, the focus is on the negligent condition that these articles stipulate. As indicated in this section, the assessments of the wrongful act condition and the negligent condition are somewhat intertwined under these articles.

The articles stipulate three widely formulated obligations/duties (hereinafter referred to as “the Duties”). This wide formulation makes the articles the most practical and wide liability bases with regard to executives, and potentially covers almost every form of misuse of the executive’s position and negligent conduct of business operations.

The Duties that are imposed in the first section of article 71 goes as follows:

The executive, “(...) when performing his rights and fulfills his obligations, he has to act in the interests of the company, and perform his rights and obligations in relation to the company with reasonableness and good faith”.²¹³

Article 44 states the same with slightly different wording:

The executive “(...) by performing his rights and fulfillment of his obligations, he has to act in the interests of the company reasonably and in good faith”.²¹⁴

The slightly different wording in the articles does not reveal any substantial differences.²¹⁵

If the Duties are violated, the consequences are stipulated in a similar manner in both of the articles’ second sections:

²¹³ (...) при осуществлении своих прав и исполнении обязанностей должны действовать в интересах общества, осуществлять свои права и исполнять обязанности в отношении общества добросовестно и разумно”.

²¹⁴ ”(...) при осуществлении ими прав и исполнении обязанностей должны действовать в интересах общества добросовестно и разумно”.

²¹⁵ Despite the slightly different wording, the literature does not distinguish between the articles, and they are regarded to be similar, as the concept of the Duties will nevertheless be the same. (see e.g. Makovskaya, Makarova, Molotnikov).

The executive “(...) bears liability vis-à-vis the company for losses caused upon the company by his negligent acting (omission).”²¹⁶

As is apparent, the wording in the first sections of the articles has a wide range of potential application. The second sections ensure that the shareholder has a remedy for restoration, which motivates the executive to act accordingly to the Duties.

The Duties stipulated in articles 71 and 44 are based on the Anglo-American legal concept of *fiduciary duties (or fiduciary obligations)*.²¹⁷ In Anglo-American law, *fiduciary duties* are widely recognized as the duties to act in the best interest of another party. The fiduciary duties are often expressed as, inter alia, the duty to act with loyalty and the duty to act with care. For instance, a corporation’s board member has a fiduciary duty to shareholders, and a trustee has a fiduciary duty to the trust’s beneficiaries, etc.²¹⁸ A breach of such duties results in liability for the wrongdoer if the conditions of causality and loss are present, as well. This term has been linguistically adapted to Russian legal literature as “Фидуциры”, and the concept is discussed in Russian legal literature with regard to the duty of the executive to act reasonably, in the interest of the company and in good faith.²¹⁹ In legal literature, the duty of acting in the interests of the company is often referred to as the *duty of loyalty* or the *principle of loyalty*.²²⁰

7.1.1 The Business Judgment Rule

The concept of the business judgment rule is developed in American court practice and plays a major role in the assessment of executives’ liability in claims for damages. It should be noted that this rule has no legal basis in Russia and is not applied by the courts.²²¹ The rule has been applied in American courts partly to protect the manager’s willingness to take economic risks and partly due to the fact that the courts often tend to lack expertise in business matters.²²² The rule stipulates that the court should presume that “decisions adopted by company managers are

²¹⁶ “(...) несут ответственность перед обществом за убытки, причиненные обществу их виновными действиями (бездействием).”

²¹⁷ Black, Kraakman and Tarassova, p. 57; Makarova, heading 4, section 5, subsection 7.

²¹⁸ For a brief definition of this term in the US, see e.g. <http://definitions.uslegal.com/c/civil-causes-of-action-breach-of-fiduciary-duty/> or <http://legal-dictionary.thefreedictionary.com/fiduciary+duty>.

²¹⁹ “действовать в интересах общества добросовестно и разумно”.

²²⁰ See for instance, Molotnikov, p. 172 et seq

²²¹ See e.g. p. 4 in Ivanov I, Teselkin F, *Legal Liability for Managers in Russian Companies* (Юридическая ответственность руководителей российских компаний), in: “Corporate Lawyer” (Корпоративный юрист), no 4, 2005 (hereinafter Ivanov and Teselkin).

²²² See definition in n 10 for the term “manager”.

reasonable, as long as the decisions were taken with adequate information and without any self-interest”,²²³ when assessing the negligence of the executive. There has been some discussion of whether it should be introduced such a rule in Russian legislation,²²⁴ but so far it has not gained support. From the author’s point of view, one argument in this discussion against an introduction of such a rule in Russian law is the fact that a high threshold for affirming a claim for damages, hence the safeguard of the willingness to take risks, is already present.

7.2 Do articles 71 and 44 derogate in favor of contracts or other federal acts?

The first question is whether the facultative provision in article 53 of the Civil Code turn articles 71 and 44 into facultative provisions as well. Article 53, section 2 in the Civil Code states that the article is facultative and derogates if other *federal acts* or *agreements* stipulate otherwise. Thus, article 3, section 2 in the Civil Code, which stipulates precedent to provisions in the Civil Code in cases of contradictions between the Code and other acts, does not apply. In this manner, article 53 yields precedent to the provisions in articles 71 and 44.²²⁵ The same conclusion derives from the *Lex Specialis* Principle.

Moreover, articles 71 and 44 state that the executive is liable inasmuch no other legal bases are provided by other *federal acts*, without mentioning contracts. Due to an antithetic interpretation, this implies that articles 71 and 44 are not facultative. Therefore, the liability may not be limited by agreements on a contractual basis.²²⁶

Concerning the derogation in favor of other federal acts, a suggestion could be that articles 71 and 44 derogate if the plaintiff pleads another special liability base in addition to articles 71 and 44 when claiming for damages. Ivanov suggests that this could be the regulation on liability in the Labor Code insofar that such basis is also asserted in the claim.²²⁷ The author was unable to find further elaborations on this matter.

²²³ Black, Kraakman and Tarassova, p. 401.

²²⁴ See eg Makovskaya, pp. 17-18 and, p. 29 in Chanturiya L, *Civil Liability for Managers in Joint Stock Companies* (Гражданско-правовая ответственность руководителей акционерных обществах), in: “Corporate Lawyer” (Корпоративный юрист), no. 2, pp. 25-30, 2007 (hereinafter, Chanturiya).

²²⁵ See e.g. Ivanov 1998, p. 101.

²²⁶ This is generally acknowledged as well. See eg Molotnikov pp. 161-162, Sadikov, article 53, Abovoy, article 53.

²²⁷ Ivanov 1998, p. 101.

7.3 The duties of loyalty, acting in good faith and with reasonableness – one overall duty?

Articles 71 and 44 stipulate three obligations (“the Duties”), which may be assessed together as one duty, or as two or three separate duties. Most of the Russian literature treats it as two duties, one as the duty of loyalty, and the other as the duty of acting in good faith and with reasonableness.²²⁸ In order to be liable, however, the Duties as a whole must be violated, since all of the Duties are intertwined.²²⁹ For instance, an action of the executive may turn out to be bad for the company, but the action was still performed in good faith and with reasonableness. In this case he is not liable. For the claimant, this delimitation does not necessarily play a big role, as he will plead that the Duties as a whole are violated.

In comparison with Anglo-American law, in which the *principle of care/the duty of care* is an essential part of the fiduciary duties, this duty is not directly provided for in articles 71 and 44. As Black, Kraakman and Tarassova point out, however, the duty of care in common law systems is referred to as acting with reasonableness in article 71.²³⁰

It is doubtful that the categorization will have any impact on the practical application of the Duties. The categorization of the three stipulated obligations is of a more theoretical interest. As apparent when examining the discussions of liability based on articles 71 and 44, this has not been a matter of concern.

7.4 Norwegian parallel to the fiduciary duties in articles 71 and 44

The customary law of a general fault-based liability for company managers in companies has been codified in Norwegian company legislation. Today, liability vis-à-vis the company and its shareholders are regulated by articles 17-1 in the JSC Act (“allmennaksjeselskapsloven”) and the LLC Act (“aksjeselskapsloven”). The term fiduciary duties is unknown in Norwegian law and the assessment under articles 17-1 refers only to the standard of negligence and does not stipulate any duties or conditions for the presence of a wrongful act. The assessment depends on a general and

²²⁸ Black, Kraakman and Tarassova compare and put on a par the duty of acting in good faith and in interest of the company to the duty of loyalty in common law systems (Black, Kraakman and Tarassova, p. 401).

²²⁹ E.g., Ivanov 1998, p. 98 and Molotnikov, p. 172 et seq. Both assert that these obligations are interconnected in the way that a violation of one of them may be reckoned as a violation of all as a whole.

²³⁰ Black, Kraakman and Tarassova, p. 400.

overall assessment of whether or not the executive is liable. However, as mentioned in section 6.1, this assessment may be divided into two questions. The first relates to whether the conduct that resulted in the loss was due to an objective wrongdoing. This implies a violation of some sort of legal acts in broad sense, such as provisions in statutory acts, articles of association or customary acknowledged general principles like the duty to act with loyalty in contractual relationships.²³¹ The presence of such a wrongful act is, albeit, not an absolute condition. The second question concerns subjective elements, such as the degree of intention and the question of whether or not any excusable factual or legal delusions made the wrongdoer initiate the harmful conduct.²³² Closer elaborations of these questions and the negligence standard are further elaborated through custom. As the rule in article 17-1 in the respective acts is of a more general and vague nature, one might observe that the liability basis for executives in articles 71 and 44 are more explicitly expressed. However, the stipulation of the Duties sets forth vague standards, and their relations to a vague negligence standard may cause confusion. This is discussed in further detail in the next section.

7.5 The assessments of the Duties in connection with the negligence assessment

A violation of the Duties on the basis of articles 71 and 44, which constitutes a wrongful act, will not lead to liability if the executive was not negligent, according to sections 2 of the articles. Article 401 elaborates the further signification of *negligence*. Section 1 of the article states that if the wrongdoer showed a sufficient degree of *care* and *diligence, taking into account the character of the obligations and business conditions*, he is not negligent (cf. section 6.1.2). Just as conspicuous as this reference, the legislation on this matter sets forth various general standards. A main question that arises in this regard is how an assessment of *care* and *diligence* differs from an assessment of the obligations to act in *good faith* and with *reasonableness*. A *good faith* assessment will, as the term indicates, rest upon whether an act was done with good intentions or with bad intentions. Bearing in mind that “intention” is a form of negligence (since negligence includes simple negligence, gross negligence and intention), the good faith assessment and the negligence assessment will be the same assessment. Furthermore, assessing reasonableness and negligence separately also constitutes an overlapping assessment, as it is hard to imagine that an executive can act unreasonably on one hand (so the wrongful act condition is met), but on the other hand not acting negligently (so the negligence condition is not met). Thus, if one assesses a breach of the

²³¹ See eg Aarum, p. 349.

²³² Aarum p. 189; Perland, p. 127.

Duties in articles 71 and 44, this also encompasses the negligence assessment, despite the fact that it is in principle two different conditions that are to be assessed separately (cf. section 6).

As early as in 1998, Ivanov stated that violating the duty of good faith and reasonableness automatically results in declaring the action as negligent.²³³ Additionally, he substantiates this with suggesting that the Duties define the degree of *care* and *diligence* (terms used to describe negligence in article 401) according to the size and character of the executive's duties.²³⁴ Makovskaya adheres to the point of view that a violation of the Duties results in declaring the actions as negligent. She adds that it is "odd" that the legislature uses the terms "care and diligence" in article 401 to describe the requirements for not acting negligently when this does not differ from the terms of acting reasonable and in good faith.²³⁵ In this way, the assessments of whether the wrongful act condition and the negligence condition are satisfied are largely left to an overall and concrete assessment.²³⁶ Or, as Makovskaya formulates it, the violations of these duties are to be perceived "through the prism of negligence".²³⁷

In comparison, in the US is the negligence condition as such not a separate condition, but more of an overall feature in the fiduciary duties. For instance, the duty of care for directors will be considered violated if the director showed *gross negligence* (see e.g. the well-known case *In re The Walt Disney Company Derivative Litigation* of Delaware Supreme Court, no. 411, 2005). If the duty is violated, in addition to the presence of causation and economical loss, the director becomes liable.

To further complicate this picture, articles 71 and 44, in section 3 respectively, states that when assessing "the basis of liability and its size", the "business turnover and other circumstances that are connected to the case" should be taken into account.²³⁸ As Makovskaya points out, the assessment of

²³³ Ivanov 1998, p. 99 with further references in support of this statement; See also Chanturiya, pp. 28-29, arguing for this comprehension of the provision; See e.g. SAC Resolution 22 May 2007 N 871/07 that merges these assessments.

²³⁴ Ivanov 1998, p. 99.

²³⁵ Makovskaya, p. 15.

²³⁶ The author's own impression while examining the literature on the subject-matter. E.g., Molotnikov treats the Duties independently of the four conditions, Shitkina, Makarova and others do not comment on the problem. Makovskaya does examine the problem and principally attaches the assessment of good faith and reasonableness to the negligence condition.

²³⁷ Makovskaya, p. 10; Despite the fact that the relationship or delimitation between the wrongful act and negligence with regard to the Duties is not clarified, the Russian legal literature has not to an extensive degree discussed these more theoretical difficulties. Nevertheless, not discussing this particular problem, the legal literature provides to some degree a mapping of the content of the Duties and the assessment of liability based on articles 71 and 44.

²³⁸ "При определении оснований и размера ответственности (...) должны быть приняты во внимание

business turnover and other circumstances are already incorporated into the definition of negligence in article 401 in the Civil Code, and thus, it is hard to see how this provision can independently influence the assessment of the liability conditions under articles 71 and 44.²³⁹ It would be more likely to perceive the motives in section 3 as already included in the assessment of either the reasonableness or negligence. Thus, it is unclear whether this provision has any independent significance. Nevertheless, in Supreme Arbitrazhnyi Court (SAC) Resolution of 22 May 2007 N 871/07 (the case is also examined in section 7.6) it is stated that this provision allows for taking concrete circumstances into consideration. Nonetheless, it is clear that concrete circumstances still play a significant role in the liability assessment. Since the provision refers to “the size” of the loss, the provision may be intended for, and applied under, the assessment of the size of the losses under the economic loss condition (for more information on this question, see section 9). Taking into consideration the above discussion, an assessment of the liability question is often conducted in the following manner:

The company or shareholder claims damages on the grounds that the executive entered a deal in bad faith, which was not in the interests of the company. For example, he concluded a purchase of over-priced goods for the company. The first assessment is typically on whether or not the deal was in the interest of the company.²⁴⁰ If there are no special circumstances, such as a favorable redemption right adhered to in the contract, an over-priced purchase would not be in the interest of the company. However, this alone is not sufficient to constitute a wrongful act. The presence of the latter rests upon an assessment of whether this deal was concluded in bad faith (i.e. the executive concluded the deal without caring for the interests of the company), and/or if it was reasonable for the executive to enter from an objective point of view. If the court finds that the non-favorable deal was entered without reasonableness or good faith, the wrongful act condition is satisfied. Subsequently, the negligence condition is to be assessed. However, the executive will be assessed negligent, as well when his action is considered in bad faith and not reasonable.²⁴¹ Additionally, when assessing the reasonableness, good faith requirements and negligence, the court can take into account concrete circumstances, as pointed out both in section 3 of the article and in section 1, subsection 2 of article 401.

обычные условия делового оборота и иные обстоятельства, имеющие значение для дела”; ”allminnelige forretningsomstendigheter for omsetning og andre forhold som har tilknytning til saken”.

²³⁹ Makovskaya, pp. 20-22.

²⁴⁰ Ivanov 1999, pp. 2-3.

²⁴¹ Ivanov 1999, p. 9.

7.5.1 The problem of applying vague standards

Inasmuch as the concepts of “good faith”, “reasonableness”, “care”, “diligence” and others are not defined in the legislation, the starting point for interpretation is the *standard everyday meaning*.²⁴²

When the terms remain vague after an interpretation based on standard everyday meaning, it is left to practice to present a more detailed picture of the content of the standards, as is the case in most Western legislations.²⁴³

However, with various categories of standards to be assessed under the partially overlapping wrongful act condition and the negligence condition, this may lead to confusion in practice. This is especially the case considering that Russian courts lack fundamental concepts of business law and the understandings of open and vaguely defined standards in the civil legislation.²⁴⁴ Courts often confuse the standards set forth by the obligations in articles 71 and 44 with that of negligence.²⁴⁵ Black, Kraakman and Tarassova also admit that fiduciary duties are unlikely to play a significant role in the near term, but emphasize that in the long-term broad fiduciary standards may “... foster a managerial culture of duty to shareholders.”²⁴⁶ Still, as the following will suggest, this long-term effect has not yet come into full effect. It is debatable that the choice to apply vague standards in addition to the negligence condition with regard to the liability regulation of managers was unwise, as it breaks from the idea of “self enforcing” legislation and bright-line formulated rules (see section 3.1).²⁴⁷

7.6 Examples of the court’s approach to assessing articles 71 and 44 and the Duties.

Most court practice shows a rather negative stand with regard to affirming liability for the executive. The examples below are chosen on the basis of how clearly the application of the conditions was expressed in the decision.²⁴⁸

²⁴² See Braginskiy and Vitryanskiy, *Contract Law* (Договорное право), vol 1, Statut Press, 2000.

²⁴³ Ivanov 1999, p. 1. Ivanov, as most Russian authors, adheres to the view that court practice can be used as a source of law that provides elaborations on vague statutory provisions (cf. 2.4.1).

²⁴⁴ Black, Kraakman and Tarassova, p. 30.

²⁴⁵ Black, et al, p. 240.

²⁴⁶ L.c.; See also *ibid*, p. 57 and p. 401.

²⁴⁷ Wolk, p. 231, criticizes the vague standards in the question of liability for executives.

²⁴⁸ Cf. n 20; The following in sections 7.6 to 7.8 shows that there are central questions with regard to the liability assessment under articles 44 and 71 that is poorly commented upon in court practice. This is mostly due to the fact that the hearing is for the large part concentrated on the evidences of the claimant rather the nuances of the law, see e.g. Efeev p 7 (cf. section 5.3.1).

In SAC Resolution 22 May 2007 N 871/07, a stockholder²⁴⁹ filed a lawsuit against the executive based on article 71 in the Act on JSC. The stockholder asserted that the executive had not settled a legitimate claim from a third party after a lengthy period of time had passed. As a result, the third party took legal actions for the settlement and the company incurred additional court expenses. As the additional court expenses were only due to the executive's reluctance to settle a legitimate claim from a third party, the stockholder claimed that this was not reasonable and not in the interests of the company. After presenting the case, the court referred the legal basis in article 71, section 2 and stated that when assessing the size and basis of liability, the business custom and other relevant circumstances must be taken into account, pursuant to section 3. Unfortunately, without further elaborating the reference to section 3. Moreover, the court merged the negligence condition with the duty of acting in good faith and with reasonableness, stating that these duties prescribe an assessment on whether the executive showed care and diligence and applied all measures for fulfilling his obligations (which is the definition of negligence in article 401). After this, the court referred to article 65 APC, which states that the claimant must prove everything he refers to, like actual losses and their size, the wrongful act of the executive and causality between the loss and the wrongful act. Moreover, the court determined that it is not negligent acting by the executive to inflict court expenses on the company. Furthermore, the court elaborated that in this case, the lower court that had satisfied the claim in this case did not sufficiently assess the concrete circumstances for how the third party's claim arose in the first place and the financial position of the company at the moment when the court expenses were due. Thus, the former decisions were overruled and the executive found not liable. As such, the court emphasizes the importance of concrete circumstances under an assessment of the Duties.

In the case Regional Federal Arbitrazhnyi Court (FAC) Moscow District 31 May 2005 no. KG-A40/4395-05, the claimant asserted that a deal made by the executive concerning a sale of real estate belonging to the company caused losses for the company in violation of article 71 in the JSC Act. The claimant asserted that the sale-price was 5,545,000 rubles under market price. The court did not consider this to be a violation of the executive's Duties since the market price only had a "supposed character"²⁵⁰ and that a sale of assets should not be considered a violation of the Duties just because there was a gap between the contractual fixed price and the market price. In this way, the ruling shows a lack of understanding when it comes to the duty of acting in the interests of the company.

²⁴⁹ See definition of this term in n 36.

²⁵⁰ "предполагаемый характер".

First, the under-price was clearly not in the interests of the company. Second, the court even in a general manner asserted that the market price had only “supposed character, even though there were no other facts (at least in the case abstract) that could reasonably explain the sub-market price from the sale.

In the case of FAC Moscow District 23 May 2005, no A40-15557/05-1344-102, the claimant asserted that the executive did not exploit the opportunity for renting out a real estate property belonging to the company. The court stated that as an “independent economic subject, the company is free to consider what it wants to do with its assets in order to achieve income”. Thus, the shareholder’s claim that the renunciation of renting the property was unprofitable did not lead to approbation, despite the fact that no other heavy evidence in favor of the executive was presented. Unfortunately, the court did not comment on where to set the limits for the “free consideration” before it constitutes a breach of the Duties, thus leaving a considerable leeway for the executive.

In FAC Ural district 27 July 2007, N F09-4914/07-C4, a company claimed damages against its former executive. While serving as executive, the defendant also served as an executive at a competing company. He entered into a deal between the two companies since both were rendering renovation work services of offices. The plaintiff asserted that the deal caused the company a loss, as it favored the second company, and that the executive was acting with self interest, which violates the Act on LLC article 44. The second company was brought into the case as a third party, pursuant to article 46 APC. After presenting the evidence, the claim and the procedure in the lower instances, the court concluded that the material presented by the claimant did not prove a loss for the company and did not prove negligence or a violation of the Duties by the defendant. Then the court emphasized that the claimant must prove what he based the claim on, pursuant to article 65 in the APC. Furthermore, the court was not convinced that the deal was done at reduced prices and then stated that there are no limitations in the legislation to sell one’s assets at reduced prices. Thus, the ruling shows that the threshold for proving the claim is high. When the court states that there is no limitation in the legislation to sell one’s goods at the reduced price, it again indicates a lack of understanding of the obligation to act in the interests of the company.

Some cases show that it is easier to get the claim for damages affirmed if the loss refers to a deal made by the executive that is already stated by the court as invalid. The case FAC North-Caucasian

District 27 Mai 2003 F08-1555/2003 is indicative of this approach. In an earlier court decision, the court deemed a deal made by the executive as invalid by pro forma. Since it was pro forma, the executive was deemed to have acted in bad faith by the court. As the deal was not in the interest of the company either, hence, he violated article 44 in the LLC Act and the losses stemming from the invalid deal could be claimed. The court did not comment upon the reasonability duty.

Furthermore, in practice, there have been cases in which executives have sold assets without involving an impartial appraiser of the assets. This is an important aspect due to the fact that one of the problems with the misuse of company assets relates to the sale or purchase of goods and services for either too low or too high of a price. If it is a requirement by statutory law to have the price fixed by an impartial appraiser, non-fulfillment of this would most likely constitute a violation of the Duties (see section 7.7.5).²⁵¹ If this is not required by the statutory provision, it depends on a concrete assessment of whether or not involving an appraiser constitutes a violation of the Duties. Typical elements of the assessment include the executive's own knowledge or access to satisfactory knowledge (e.g. from his staff), if the market price is well known already, etc.²⁵² In FAC Moscow District's Resolution 19 February 2002, no N KG-A40/547-02, the CEO²⁵³ in OAO "Beskudnikovskiy kombinat stroitelnix materialov" had sold company real estate to ZAO "Firma Poisk" for the price of 200,000 rubles. An appraiser, OOO "Price Inform", estimated in the court hearing that the value was 800,000 rubles. The lower instances had concluded with that this was a violation of article 71, and that such a violation would allow the contract to be declared invalid on basis of article 168 in the Civil Code. The article states that a contract not in accordance with the law, in this case article 71, is invalid. Obviously, one cannot claim a deal is invalid while at the same time claiming damages that are due to the consequences of this invalid deal, as it would as if it was valid (however, claiming invalidation along with damages that incurred in order to put the parties in a position as the deal was never concluded invalid deal incurred is naturally allowed). In this way, the lower court confused the conditions for invalidation with the conditions for claiming damages. The higher court affirmed, however, that the sale was indeed a violation of article 71, as such a deal could not "safeguard the interests of the company". However, such a violation does not make it a base for declaring the contract void under article 168. In this way, the higher court cleared up the mistake by the lower instance, but this also revealed the first instance's lack of understanding of the

²⁵¹ Information letter by SAC, 30 May 2005, N92.

²⁵² Makovskaya, p. 19.

²⁵³ See definition of this term in n 11.

relations between fundamental concepts like liability and invalidation. It also shows that an appraiser may play a significant role when determine whether or not a sale or purchase is in the interests of the company, despite FAC Moscow District 31 May 2005 no. KG-A40/4395-05 statement about the “supposed character” of the market price.

Overall, the cases show that the threshold for getting a claim affirmed is indeed high. Especially worrying is how some courts have granted the executive too much latitude when the deals that were concluded obviously were not in the interest of the company.²⁵⁴

7.7 The assessment under the Duties

7.7.1 Acts with recommending character, the Code of Corporate Governance

The question here concerns whether acts with only recommending character, i.e. not binding legal acts, provide guidelines when assessing the content of the Duties.

In corporate legislation among Western countries, recommended but non-binding regulations are widespread.²⁵⁵ In Russia, a Code for Corporate Governance was elaborated in 2002 by the Federal Commission on Securities,²⁵⁶ based on the OECD’s “Principles for Corporate Government”, and adopted on the Ministry Session, 26 - 27 May 1999. The Code concerns, inter alia, a range of questions regarding liability for managers and provides concrete obligations (e.g. establishment of procedures to disclose company information to shareholders) for the executive. More general statements of the content of the Duties are also provided for. For example, heading 4, section 3.1.1, states that the executive must show the necessary care and diligence that is expected of good managers in similar situations and circumstances.

It was recommended by the Commission to adopt the Code in the internal documents of the company,²⁵⁷ but so far it has not achieved any widespread adoption in Russia. Several authors assert that the code still casts some light on the content of the Duties, since the code provides

²⁵⁴ Black, Kraakman and Tarassova, pp. 401-403, are comparing the Russian “simple negligence” condition to correspond to a “gross negligence” in “other western countries; Black, et al, p. 240, state that if a shareholder files a claim for a damages against company bodies, the outcome is “rarely in their favor”.

²⁵⁵ Molotnikov, p. 67.

²⁵⁶ Letter FFMS 4 April 2002 N421 (распоряжение ФКЦБ от 4 апреля 2002 г. N 421/р «О рекомендации к применению ”Кодекса корпоративного поведения”) (hereinafter, FFMS 2002).

²⁵⁷ FFMS, 2002.

recommended obligations for managers.²⁵⁸ Thus, inasmuch as the provisions are well-considered and balanced, they may serve as guidelines, offering a mapping of the standard of the Duties.

Even though the Code is facultative, it is debatable that the standards postulate positivistic aspects of the content of the Duties. For instance, under Norwegian contract law, it is generally recognized that well balanced guidelines that are worked out by organizations in a business sphere may be given significant importance when evaluating standards, regardless of whether the guidelines have been accepted by the parties or not. However, as far as the author has reviewed court practice, the application of these norms has not been given sufficient weight when interpreting the principles. Not acting in accordance with the Code will nevertheless constitute an argument in favor of establishing liability.²⁵⁹

Another form of guidelines is provided with reference to *business custom*. According to section 3 in articles 71 and 44, section 3 in the Acts on JSC and LLC, business custom should be taken into account in the assessment of liability. Moreover, one might argue that the Code of Good Governance is a business custom and thus must be taken into consideration due to the aforementioned articles. Generally, article 5 of the Civil Code defines that a business custom is a well established and widely applied conduct (insofar it is not contradicting legal norms). It is doubtful whether the Code of Good Governance would qualify as a business custom based on article 5. However, other good practices concerning the performance of the executive, which at the same time is widespread among companies, may serve as guidelines under the assessment of articles 71 and 44.

7.7.2 Particularly about the duty of loyalty

The following provides further details on the duty of loyalty and its relation to the interests of the company.²⁶⁰ First of all, the main purpose of establishing companies is to generate profit, according to article 50, section 1 in the Civil Code. Thus, the main duty of the executive is to generate profit for the company. This implies that the actions of the executive must serve long-term goals for

²⁵⁸ Molotnikov, p. 181.

²⁵⁹ See e.g. Makovskaya, p. 17.

²⁶⁰ See e.g. Ivanov 1999 p. 2; One might see some other concrete provisions that are inspired by the duty to act loyally, like, for example, the prohibition of not taking positions in competing companies (the JSC Act article 69, section 3, subsection 4). See for some comparisons, Ivanov 1999, p. 4 and Molotnikov, pp. 172-176

achieving stable income and avoiding hazardous risks.²⁶¹ Second, this implies that the executive cannot pursue his private interests at the expense of the company.²⁶²

An important aspect of the duty of loyalty is its duration. Ivanov states that the duty of loyalty should not be interpreted to be effective only for the time the executive is under contractual relationship with the company, but also after the executive has ended the relationship with the company.²⁶³ This is to safeguard non-disclosure of commercial secrets.

When it comes to abuse of corporate funds, such activity mostly occurs in connection with the conclusion of contracts, wherein the executive possesses self-interest.²⁶⁴ Concluding a contract, in which the executive has a self-interest, may constitute a violation on the duty to act in the interests of the company.²⁶⁵ These situations are more extensively regulated by article 84 in the Act on JSC and article 45 in the LLC Act (and provide a special liability base, see section 8.1.5). Even though these articles specifically regulate the question of conflicting interest, there are no obstacles to base a claim from such a situation under articles 71 and 44, due to the latter's wide scope. This may be especially practical when the factual circumstances are only loosely covered by articles 81-84.

7.7.3 The question of liability when taking business risks

It is generally acknowledged that taking normal business risks does not create liability for the executive.²⁶⁶ Karabelnikov states that risks taken within the frame of *typical business risks* will not be considered as a violation of the Duties.²⁶⁷ He outlines typical business risks as the following: 1) when acting in accordance with contemporary knowledge and experience; 2) when the recognized goals of the company could not be reached by any other means than that which were taken; 3) when measures have been taken to prevent possible losses commensurate to the risks; and 4) when the object of the risk is of material value and it does not threaten the life and health of anyone.²⁶⁸

²⁶¹ Ivanov 1999, pp. 2-3.

²⁶² L.c.

²⁶³ L.c.

²⁶⁴ Ivanov and Teselkin, p. 4.

²⁶⁵ Makovskaya, p. 16.

²⁶⁶ See e.g. Telyokina, to article 464.

²⁶⁷ P. 33 in Karabelnikov B R, *Labor relations in Companies* (Трудовые отношения в хозяйственных обществах), Moscow, IDFBK-PRESS (ИД ФБК-ПРЕСС), 2003 (hereinafter, Karabelnikov).

²⁶⁸ Unfortunately, court practice leaves few elaborations on what to include into typical business risks.

7.7.4 Individual circumstances with the executive

Lack of qualifications, experience or knowledge does not mitigate the executive's liability.²⁶⁹ If such deficiencies are present, the executive is negligent and/or unreasonable for accepting the role as an executive body without taking appropriate measures to overcome his lack of qualifications.²⁷⁰

If it is objectively impossible for the executive to fulfill his obligations he is not liable.²⁷¹ The same applies if the executive gets an acute illness.²⁷²

7.7.5 The Duties with regard to violations of other statutory provisions and company documents

Violation of concrete obligations that are derived from statutory provisions (e.g. violation of tax legislation, labor legislation or corruption), as well as direct violations of the articles of association or instructions made by the general meeting (GM) or (BD), constitute a wrongful act.²⁷³ When basing the claim for damages on articles 71 and 44, the wrongful act is not enough to constitute a violation of the Duties.²⁷⁴ When there has been a violation of concrete obligations, a concrete overall assessment must follow. This assessment determines if the executive acted reasonably, in good faith and in the interest of the company when the wrongful act occurred.²⁷⁵ As mentioned earlier, this assessment will coincide with the negligence assessment (see section 7.5). Only if this is confirmed, a violation of articles 71 and 44 has been committed.²⁷⁶

A violation of concrete obligations will, however, usually lead to a violation of articles 71 and 44, as well. In principle, the articles are interpreted in a way that to act in accordance with the Duties implies not to act against the law, even if this benefits the company in the short term.²⁷⁷ This can be deduced logically from the Duties; if the executive is dealing with businesses on the edge of the law, it may be considered reasonable and in good faith vis-à-vis the company since he is seeking all possible means of income (additionally, such business may not result in any claimable losses). However, if the company is investigated by law-enforcement authorities, this would most probably

²⁶⁹ Ivanov 1999, pp. 5 and 8; Chanturiya, p. 29.

²⁷⁰ See Chanturiya, p. 29 and Ivanov 1999, p. 5.

²⁷¹ Ivanov 1999, p. 9.

²⁷² Shitkina, p. 474.

²⁷³ Ivanov 1999, pp. 8-9.

²⁷⁴ Karabelnikov, p. 33; Ivanov 1999, p. 9.

²⁷⁵ Ivanov 1998, p. 99; Ivanov 1999, p. 8-9

²⁷⁶ Ivanov 1998, p. 99; Ivanov 1999, p. 8-9

²⁷⁷ Ivanov 1999, p. 6.

lead to losses for the company. A crack-down on the company by the authorities would almost never be in the interests of the company. Thus, taking such risks would be neither in the interests of the company nor reasonable. Hence, a violation of statutory law would constitute a violation of articles 71 and 44.

Nonetheless, the assessment provided for by the Duties ensures that minor violations are not automatically deemed as a violation of the Duties when the executive has “excusable” grounds for his actions. This is, albeit, limited to “force majeure” situations that force the executive to undertake a minor violation of company instructions or company legislation in the interests of the company. For instance, it is not a wrongful act if the shareholders do not get the invitation for the GM in time (as stipulated in the JSC and the LLC Act) due to technical problems at the company’s head office. This matter is clearly out of the executive’s control. Another possibility is that the executive postpones the GM in order to prepare the accounts for the GM, as they were delayed by the accountant. Numerous such instances may occur. However, if the GM was postponed because the executive had not prepared it properly (e.g. the executive opposed items on the agenda and therefore deliberately delayed the GM, or the executive forgot to send the agenda to the accountant), this would represent a violation. Notably, such violations rarely result in provable economic losses for the company. Nonetheless, economic losses are not out of the question. For instance, The GM was supposed to merge the company with another one in order to gain needed financial resources. This decision had to be adopted within a certain limit so that the contractual partner did not withdraw from the merging plans due to excessive delays. If the executive manages to hinder the gathering of the GM, and thus prevents the merger, the company will likely suffer financial losses.

Furthermore, several concrete obligations are laid out in the respective Acts on JSC and LLC, the articles of association, other internal corporate documents and the labor contract with the executive (or commercial contract with a managing company). Examples of such concrete obligations include the duty to organize the GM, pursuant to article 69, section 2, subsection 2 in the Act on JSC and article 34 stipulates a duty to summon the GM, while article 35, section 2, regulates the gathering of an extraordinary GM. Other obligations consist of keeping information available for the shareholders, which they have rightful access to at the office of the executive, pursuant to article 36, section 3 in the LLC Act and article 52, section 3, in the JSC Act. Article 89, section 2 in the JSC Act stipulates obligatory storage of a wide range of documents at the office of the executive body,

which also carries out the storage and the presentation of it for stockholders on request, pursuant to article 91, section 1.²⁷⁸ The executive must conduct the protocol of the GM and distribute it among the shareholders on demand, pursuant only to the Act on LLC article 37, section 6. In a merger of companies, the elected executive is obliged to execute the registration of companies pursuant to article 52, section 4 in the LLC Act.²⁷⁹ The executive must fulfill the decisions made by the GM and the BD, pursuant article 69, section 2 in the JSC Act and article 40, section 4 in the LLC Act. Article 69 in the JSC Act, section 3, subsection 4 states that the executive must not be involved in the management of other organizations without permission of the BD. It should be noted that in LLC, a similar provision is not provided for; thus a concrete assessment will be used to determine if holding a position in other companies is in conflict with acting in the “interest of the company”, pursuant to article 44, section 1.²⁸⁰

In addition, concrete obligations may be derived from the executive’s competence. Besides the competence that is provided in the Acts, the company may have its own provisions on competence in the articles of association. Notably, violations of these obligations are unlikely to cause substantial losses for the company.

7.7.5.1 Liability for correct information, accounts and bookkeeping – especially stipulated in the JSC Act

Article 88 in the JSC Acts contains an obligation for the executive to maintain proper annual accounts, bookkeeping, financial statements and other information relating to the company’s operations in accordance with the JSC Act and other legal acts of the Russian Federation. This is, intern alia, a reference to that the bookkeeping must be in accordance with the Act on Bookkeeping,²⁸¹ in addition to several acts adopted by federal bodies concerning accounts and bookkeeping.²⁸² Further, it stipulates that this information should be duly presented to the stockholders.²⁸³ The second section in the article stipulates liability in case of non-compliance with

²⁷⁸ Telyokina, to article 91.

²⁷⁹ Where there are reorganizations of companies in JSC, the executive’s duties are given by decisions of the GM. See e.g. article 16, section 3, subsection 1.

²⁸⁰ E.g. see FAC Ural district 27 July 2007, N F09-4914/07-C4 (referred in section 7.6), where holding a position in a competing company was not considered to be a violation of the duty to act in the interests of the company.

²⁸¹ Federal Act on “Bookkeeping” of 21 November 1996 (Федеральный закон от 21 ноября 1996 г. N 129-ФЗ “О бухгалтерском учете”).

²⁸² Telyokina, to article 88.

²⁸³ Telyokina, to article 88, who further elaborates on this.

the present Act. This is a reference to article 71 in the Act.²⁸⁴ Thus, a violation of article 88 must also violate the Duties in order to establish liability for the executive on the basis of article 71. In this way, the stipulation of liability in article 88, section 2 does not play an independent role in the liability, since the question under article 71 remains the same; that is, whether the violation of article 88 is undertaken in the interest of the company, in good faith and with reasonableness.

7.7.5.2 Violation of the regulations of entering major transactions (крупная сделка)

Articles 78 and 79 in the Act on JSC and article 46 in the Act on LLC set forth a special procedure when the company enters into major deals. The objective of this provision is to ensure shareholders' control over major deals and the disposal of company assets. The articles stipulate that in case of disposal of more than 25% of the company's assets (assessed on the balance stated in the last quarterly balance sheet of the company),²⁸⁵ such disposal must be approved by the BD. If no BD is formed, then the GM is required to approve it. If the disposal implicates more than 50% of the assets, it must be approved by the GM.

Article 79, section 6 in the JSC Act and article 46, section 5 in the LLC Act provide the company with the right to claim a deal that is concluded in violation of the regulation of "major deals" invalid. A claim for damages, however, must be based on articles 71 and 44. A violation of the regulation on "major deals" constitutes a wrongful act in itself, but in order to be liable on the basis of articles 71 and 44, as mentioned above in this subsection, the claimant must prove that this violation also implies a violation of the Duties. As mentioned under section 7.6, it is typically easier to get a claim affirmed if it is previously affirmed as invalid by the court.²⁸⁶

An exception from the prescribed procedure for affirming major deals involves situations in which such disposal is a part of the company's "normal business operations". The term is similar to the term under article 84 in the JSC Act and article 45 in the LLC Act, which regulate deals involving a "personal interest"²⁸⁷ (see section 8.3) and provides an exception from the procedure of approval if the deal is a part of "normal business operations." The terms are to be understood equally.

²⁸⁴ L.C.

²⁸⁵ Information letter SAC 13 March 2001 no 62 supplies the Act on JSC with some general statements, but does not concern liability in particular.

²⁸⁶ It was hard to find literature that discusses the issue of liability in connection with "major transactions". Most discussions relate only to the question of invalidation.

²⁸⁷ See definition of this term in n 167.

The GM may approve the deal subsequently, pursuant to Supreme Court (SC) and SAC 9 Resolution December 1999 No 90/40, item 20.²⁸⁸

If the deal is both “major” and with “personal interest”, the article 79, section 5, states that the deal is subjected to the regulation that addresses deals involving personal interests. This regulation provides for its own liability base, as well (see section 8.3). The Act on LLC has no equivalent rule in this situation. Thus, the claimant should base his claim on a violation of both regulations.

7.8 How to prove that the conditions are met and problems with the burden of evidence

7.8.1 The presumption of good faith reasonableness and the presumption of absence of negligence

In principle, fault-based claim for damages include a presumption of negligence on behalf of the wrongdoer, pursuant to articles 401, section 2 and 1064, section 2 in the Civil Code. Nevertheless, this presumption does not apply in all situations. Article 10, section 3 in the Civil Code, provides an exception, stating that when good faith and reasonableness (as stated in articles 71 and 44) are the duties of which a violation constitutes the wrongful act, then good faith and reasonableness are presumed to be present.²⁸⁹ Most Russian authors interpret this provision in the way that it alters the negligence presumption with regard to liability based on articles 71 and 44 in favor of the managers.²⁹⁰ Notably, however, no distinction is made between the negligence presumption and the presumption of good faith and reasonableness with regard to article 10. Since the assessments of the violation of the Duties and negligence are merged, the presumption of good faith and reasonableness precedes the presumption of the absence of negligence. Consequently, the burden of evidence for proving the wrongful action (violation of the Duties) and the presence of negligence are formally laid upon the claimant, in accordance with article 10. For instance, if the executive did not conduct the GM in the prescribed manner, he thus violated this concrete duty. The claimant has the burden of evidence for proving that the delay was a violation of a concrete obligation. In addition, and more

²⁸⁸ More details in Shitkina, p. 501, et seq.

²⁸⁹ The provision has the following wording: “В случаях, когда закон ставит защиту гражданских прав в зависимость от того, осуществлялись ли эти права разумно и добросовестно, разумность действий и добросовестность участников гражданских правоотношений предполагаются.”

²⁹⁰ See e.g. Molotnikov, pp. 159-161. An exception from the general perception of this is Telyokina, to article 71 (the only one that, insofar the author could find).

difficult to prove, the claimant must also prove that the executive neither showed good faith nor reasonableness and the violation of conducting the GM in the prescribed manner was not in the interests of the company. When this is proved, however, in most cases the negligence will also be proved. There are none of the reviewed court cases that apply a presumption for negligence. There is an ongoing discussion on whether or not the presumption of good faith and reasonableness with regard to managers is an apt solution. The main reason to stipulate a presumption of good faith and reasonableness is, according to Molotnikov and Osipenko,²⁹¹ that if the burden of proof had remained with the executive, this would result in a reduction in willingness to accept the position as executive and increase the chances of minority shareholders' "greenmailing" the executive.²⁹² According to court practice and the majority of scholars, the problem of the high thresholds favors the executive in the negligence/bad faith/reasonableness assessment.²⁹³ This is especially due to the fact that the thresholds for considering something proven, when there is a presumption for the opposite, are quite high in Russian courts. This may lead to many cases in which material legitimate claims are lost because of the way judges apply the rules on evidence. Thus, from the author's point of view, since the executive is in a far stronger position than minority shareholders, and since the latter's interests are worth protecting, one might question the suitability of the presumption rule.²⁹⁴

In comparison, the principle of presumption of negligence, including for the executives, prevails in Germany.²⁹⁵ Under Norwegian law, the claimant has the burden of proof for establishing the defendant's negligence.²⁹⁶ However, if the court finds that the action of the executive was, from an objective angle, wrongful (e.g. he violated an instruction of the GM or violated a statutory provision when conducting the business of the company), it is the executive that must prove that there are subjective elements that excuse the wrongful act (known as the rule of "pending the burden of proof"), and in this way prove that he was not negligent.²⁹⁷

²⁹¹ Molotnikov, p. 161; Osipenko's chapter 7.6 is dedicated to problems of, inter alia, minorities' misuse of this remedy in Russian corporate sphere; Black et al, pp. 40-49, discuss the presumption in comparison with the other countries in the study, and basically adhere to the mentioned position of protecting the willingness of taking risks.

²⁹² "Greenmailing" is used in Russian corporate terms as a general term when a part in a corporate relation is trying to exploit a stronger situation vis-à-vis other parts. Osipenko's book is dedicated to this topic.

²⁹³ Molotnikov, pp. 159-161.

²⁹⁴ Agreeing with this, Chanturiya, p. 29, emphasizes the German approach, which presumes the executive's negligence.

²⁹⁵ The Joint Stock Company Act of the FRG of 6 september 1965 § 93, section 2 and § 117, section 2. The German regulation is often referred to when Russian scholars discuss the presumption of good faith and reasonability. See especially Molotnikov, pp. 159-161 and Shitkina, p 477.

²⁹⁶ Aarum, p. 71.

²⁹⁷ Aarum, p. 221.

7.8.2 What the claimant must prove in a claim for damages based on articles 71 and 44

In addition to the presumption of good faith, reasonableness and absence of negligence, the claimant has the burden of proof for all other assertions that he advances, pursuant to article 65 in the APC. The article states that a party's assertions must be proven by the same party that is putting them forward. With regard to claims for damages, SAC Resolution 22 Mai 2007, no 872/07, states that the defendant must prove: losses, the size of the losses, the causality between the act and wrongful act, negligence and the wrongful act. This establishes the whole burden of proof on the claimant. The court's statement was based on article 65 in the APC.²⁹⁸

In addition to the burden of proving a violation of the Duties, another difficulty has arisen in practice with regard to indirect lawsuits. In some cases, shareholders have also had to prove that *his interests or rights* are infringed by the wrongful act. This is due to the formulation of article 15 in the Civil Code, stating that "the person, who had his rights infringed, may claim full recovery".²⁹⁹ In a claim based on articles 71 and 44, the company is the entity whose rights are infringed, not (directly) the shareholder. Obviously, the shareholder still has indirect interests in the recovery of losses for the company. That notwithstanding, the indirect interest has not, in some cases, been sufficient for Russian courts to overcome the wording in article 15. For instance, FAC Resolution Moscow District 15 December 2005 no KG-A40/12187-05, and SAC Resolution 22 Mai 2007 no 872/07, conclude that the stockholder must also prove that his rights are infringed according to article 15. Due to diverging practice, it is uncertain whether this sets forth a general requirement, or if it was a "one-time case". To be sure, the claimant should be prepared to prove some sort of infringement.³⁰⁰ Nonetheless, it should be relatively easy to prove the link between the direct loss for the company and the indirect loss for the shareholder.

7.9 The form of liability for the managing company

The Civil Code article 103, the Act on JSC article 69 and the Act on LLC article 42 all state the possibility to transfer the power of the executive body to a managing company. The managing company acts in the name and on the account of the company, according to article 53 in the Civil

²⁹⁸ The large majority of the examined court rulings state a heavy burden of proof on the claimant. See e.g. FAC North-Caucasian District, 17 August 2006 N Ф08-3470/2006, FAC Northwest District, 5 April 2004 N A66-5248-03 and FAC West-Siberian District, 15 September 2005 no 4-5645/2005 14403-A75-8.

²⁹⁹ "Лицо, право которого нарушено, может требовать полного возмещения".

³⁰⁰ Osipenko, pp. 477 and 483; Dobrovolskiy, p. 235.

Code. Article 401, section 3 in the Civil Code stipulates strict liability, with an exception for force majeure during breaches of contractual provisions when the liable party is performing as a professional commercial party (as a managing company does). The question at stake is whether or not the Acts on JSC and LLC (providing fault-based liability), as Lex Specialis rule, alter the general statement of article 401. Article 401, section 3 is facultative and states that it derogates in favor of other federal acts. Thus, the Acts on JSC and LLC state an exception from the main rule. Mogilevsky takes it for granted that articles 71 and 44 also establish fault-based liability for the managing company.³⁰¹ Telyokina also takes this position, stating in her Commentary that article 71 in the JSC Act makes a favorable position for managing companies.³⁰² On the other hand, Makarova asserts that managing companies bear liability independently of negligence, but without substantiating it.³⁰³ In fact, the question of the matter has more theoretical interest. This is due to the fact that the Duties in articles 71 and 44 provide an assessment that coincides with the negligence assessment, thus narrowing a potential strict liability with exceptions for a force majeure basis to a virtual fault-based liability.³⁰⁴ In this way, a managing company will benefit from the “good faith” and “reasonableness” duties and only become liable if it acted negligently. As the hiring of managing companies is not that widespread among Russian companies, the author did not find any court practice that cast further light on this issue.

A claim for damages from third persons on the basis of the managing company’s actions done in the name of the managed company will be directed against the managed company. In case of an approbation of such a claim, this allows for a recourse claim from the managed company against the managing company. The recourse claim may be based on article 71 or 44.

7.10 Conclusions with regard to the assessment of Duties

As stated above, there are several problems with the application of the Duties. The distinction of the wrongful act condition under the Duties and the negligence condition presents a particular problem. From the author’s point of view, it may be more appropriate to follow the idea of a “self-enforcement” model (as described in section 3.1) with a set of more clearly defined rules when it

³⁰¹ Mogilevskiy, chapter 10.1. Mogilevskiy S D, *Legal basis for activities in Joint Stock Companies: Textbook* (Правовые основы деятельности акционерных обществ: Учебник), Delo (Дело) Publishing House, 2004 (provided by Garant, without paginating).

³⁰² Telyokina, to article 64.

³⁰³ Makarova, heading 4, section 5, subsection 7.

³⁰⁴ Black, et al, p. 136.

comes to the question of liability for managers. As of today, the Russian legal precedence on how to aptly define the degree of good faith and reasonableness is nearly absent.³⁰⁵ Chanturia, for instance, is highly critical of the vague standards and supports strict liability in cases of violation.³⁰⁶ As Molotnikov also concludes, application of the articles is not adequately regulated and further elaboration by the legislature is required.³⁰⁷ Black et al. suggest that a non-exhaustive criteria be established for any conduct considered to be in “bad-faith” and unreasonable in concrete situations.³⁰⁸

Furthermore, the relationship between the different liability bases is problematic. This might include the relationship between article 71 and the liability regulation in the Labor Code, as well as the liability bases in the Civil Code, such as article 53, and liability bases in other federal acts. The nuances and the relations between these bases are not sufficiently elaborated by the legislature, court practice or legal literature.³⁰⁹ This, together with high thresholds for proving a claim, is unfortunately likely to result in the material loss of legitimate claims.

Finally, it should be unnecessary for the claimant to prove some sort of infringement,³¹⁰ as it should be obvious that he has an economic interest in the recovery of company losses. On the whole, it is concluded that the legal stance concerning liability for the executive with regard to court practice and legal literature is neither uniform nor deterrent, and calls for further elaboration and clarification.

Companies should adopt the Code of Corporate Governance, and the articles of association should clearly stipulate the grounds for managerial liability. Companies should also assess the need to limit the executive’s right to act and sign in the name of the company,(or share it with the chairman of the BD), to minor dealings in daily business operations. In particular, competence to represent the company during legal proceedings is an essential role that should not be limited to the executive of the company, i.e. shared with the chairman of the BD.

³⁰⁵ Black, et al, p. 25.

³⁰⁶ Chanturiya, p. 29.

³⁰⁷ Molotnikov, p. 182.

³⁰⁸ Black, et al, p 25.

³⁰⁹ When it comes to recommendations of legislative amendments concerning liability for managers, the report of Black et al gives a detailed discussion on different solutions that could improve the legislation on this matter.

³¹⁰ Osipenko, pp. 477 and 483. Dobrovolskiy, p. 235.

7.10.1 Are serious problems of affirming a claim for damages in conflict with the provisions in the European Human Rights Convention?

An interesting question is whether or not the procedural obstacles in an indirect lawsuit, the problem of burden of proof and the lack of possibilities to enforce an appropriated claim for damages constitute a violation of the ECHR article 6, stipulating a “rightful legal procedure” and the optional protocol 1 to the ECHR, article 1, stipulating the right to protection of property. Both Conventions are ratified by the Russian Federation. Unfortunately, these questions are too extensive for further elaboration in this thesis.

8 Particular regulation and bases of liability in certain situations

This section concerns civil liability with other special bases than articles 71 and 44.³¹¹ Since the main focus of this thesis is on articles 71 and 44, the following only provides an overview of different types of liability bases. Some emphasis, however, is put on claims based on the provision regulating personal interest,³¹² as this is of the most practical interest to the company and its shareholders (in addition to articles 71 and 44).

Notably, the relationship between the specific and general bases in articles 44 and 71 in the Acts on JSC and LLC are not elaborated upon in Russian legislation or literature (cf. sections 7.2 and 7.10).³¹³ However, section 2 of articles 71 and 44 states that the articles may be derogated from if other federal acts do stipulate another basis. Thus, the claimant may choose another applicable liability base if the liability bases are overlapping.

8.1 The labor regulation as a legal basis of liability for the executive

At present, there is a discussion on the labor legislation's position on the executive with regard to company legislation.³¹⁴ The Labor Code also provides a liability base for managers.³¹⁵ Article 277 in the Labor Code, section 1, states that the executive has “full material liability for direct, real damages”.³¹⁶ “Real damages” are defined in article 15 in the civil code (see section 9 for elaboration) and do not encompass lost profit.

³¹¹ Note that the conditions for liability concerning economic loss and causality treated in section 8 and 9 with special regard to articles 71 and 44 will generally apply to these bases of liability as well.

³¹² See definition of this term in n 167.

³¹³ The author was not able to reveal any meaningful literature or judicial practice on this matter. Probably this is due to such question may have not been put properly on stake yet in practice.

³¹⁴ See e.g. Pasjin; Black, et al, pp. 121-135.

³¹⁵ See Black, et al, p. 123; See definition in n 10 for the term “manager”.

³¹⁶ “Руководитель организации несет полную материальную ответственность за прямой действительный ущерб, причиненный организации.”; “Material damages” (“материальная ответственность”) is the liability form that applies to the relations between the employer and employee in the Labor Code. It implies that only *real damage* (i.e. excluding lost profit) can be claimed by the sufferer (see section 9.3.1).

Section 2 states that managers may be liable on bases set forth by other federal acts, such as articles 71 and 44.³¹⁷ If another basis is applied, “losses are to be understood as losses in the civil legislation.” This implies a reference to article 15 in the Civil Code, which regulates the measurement of the size of losses in a claim for damages, as it indicates “full recovery” of losses.³¹⁸ Naturally, full recovery is a more favorable to claim than real damages, as it includes lost profit. Hence, from the claimant’s point of view, the liability bases in articles 71 and 44 are more favorable for making a claim. It is also notable that the material found in the literature and in practice deals with claims for damages against executives is based on articles 71 and 44,³¹⁹ and not labor legislation.

8.2 Stockholder’s and company’s direct claim on the basis of article 71, section 2, subsection 2

The Act on JSC states fault-based liability for the executive directly vis-à-vis stockholders³²⁰ in one specific situation (cf. section 4.3). Pursuant to article 71, section 2, subsection 2, the executive is “(...) liable vis-à-vis the company and the stockholder for the negligent violation of the procedure of subscription of stocks, regulated by section 11.1 in the Act”.³²¹ Section 11.1 consists of articles 84.1 – 84.10. Since this provision states direct liability vis-à-vis the stockholder, the stockholder can claim his loss, regardless of the company’s loss. The company may concurrently claim *its own losses* against the executive on basis of the same violation of section 11.1.

Section 11.1 outlines a detailed procedure with regard to the acquisition of more than 30% of the stocks in an open JSC company. Section 11.1 is a new provision stipulated to protect the stockholder’s and the company’s interests and to ensure that the executive does not hamper such acquisitions. Article 84.3 lists a number of duties for the company to perform, in the form of the

³¹⁷ “В случаях, предусмотренных федеральными законами, руководитель организации возмещает организации убытки, причиненные его виновными действиями. При этом расчет убытков осуществляется в соответствии с нормами, предусмотренными гражданским законодательством.”

³¹⁸ See the commentary to article 277 in Ananuy K Y, et al, *Commentaries to the Labor Code* (Комментарий к Трудовому кодексу), Omega L (Омега-Л) Publishing House, 2007 (hereinafter, Ananuy).

³¹⁹ E.g. Telyokina, to article 69, section 3, subsection 3; Makovskaya. pp. 7-8; The author has not been able to find one case where the claim for damages against the executive was based on the labor legislation.

³²⁰ See definition in n 36.

³²¹ “(...) несут ответственность перед обществом или акционерами за убытки, причиненные их виновными действиями (бездействием), нарушающими порядок приобретения акций открытого общества, предусмотренный главой XI.1 настоящего Федерального закона.”

executive, when it receives an offer to purchase more than 30% of the stocks. For example, the executive has to communicate the offer to the stockholders. If the executive fails or even hinders the accomplishment of such transactions, he may be liable. Owing to the fact that articles 71, section 2, subsection 2 stipulate fault-based liability, the liability depends firstly on the presence of a violation of the said procedures, constituting the wrongful act. Second, the violation has to be committed negligently. Third, there has to be an economic loss proximate to the violation (cf. section 6.1).

8.3 Liability in cases of the personal interest of the executive entering deals made in the name of the company

Heading 9 in the JSC Act (articles 81-84) contains a special regulation regarding situations in which the executive has a personal interest.³²² Article 84 in the JSC Act provides a special liability basis for the executive if he concludes a deal with personal interest without following the special procedure that is stipulated in heading 9 for concluding such deals. In principle, the area of application of this liability base falls within the scope of article 71. Legislators chose,³²³ however, to provide a more concretely formulated liability basis in this article, as it has been an ongoing problem in Russia that executives act with personal interests.³²⁴

Article 84, section 2, states that the executive is liable vis-à-vis *the company*. Thus the shareholder may not file an indirect lawsuit on this basis.³²⁵

The provision states that the executive is liable if he violates the procedure for entering deals with a possible personal interest. It does not mention whether this liability is fault-based or strict. Pursuant to article 401 in the Civil Code, liability in contractual relations is fault-based if nothing else is stipulated. When interpreting the article in light of the general provisions in the Civil Code, the negligence condition should be implemented into article 84, in accordance with article 401.³²⁶

³²² See translation of this term in n 167.

³²³

³²⁴ However, there is a discussion whether this protection is efficient. Shitkina, p. 509 asserts that the regulation of the presentation of information is not sufficient in order to be an effective protection of the shareholders interests. Nor are there many cases based on this provision. The author found only few cases that treats article 84, section 2, which of only two gave some meaningful considerations.

³²⁵ Nevertheless, both provisions seeks to protect the interests of the company, and hence indirectly the shareholders. It should be appropriate to stipulate the same possibility for the shareholders to file an indirect lawsuit, as provided in article 44 and 71 with regard to the LLC Act 45 and JSC Act 84.

³²⁶ Same in Black, et al, p. 52.

Article 84 in the JSC Act states two possible legal consequences and remedies for restoration: a claim for invalidation of the deal (first section) and a claim for damages (second section). Telyokina asserts that in order to claim for damages on the basis of second section, the deal must be found invalid beforehand, without substantiating this any further.³²⁷ The article could be interpreted to mean that it would be more likely to consider the two remedies as possible alternatives (since the remedies are expressed in different sections of the provision), or as remedies to be applied in combination. In support of this view, FAC North-Caucasian District 19 August 2003 no Ф08-2955/03 stated that an earlier invalidation of a deal grounded on article 84, section 1 does not have prejudicial character when deciding the question of awarding damages.

8.3.1 The corresponding provision in the LLC Act

Article 45 in the LLC Act contains a corresponding provision that stipulates a specific procedure for concluding deals in which the executive has a personal interest. There is, however, one important difference between article 45 and article 84, which is that the former does not stipulate that one becomes liable if the provision is violated. In this manner, article 45 does not provide a liability basis, while the general liability basis in article 44 still applies. Thus, it needs to be assessed whether a violation of article 45 constitutes a violation of the Duties provided in article 44, as well. Since article 45 does not provide a liability base, only the provisions in the JSC Act are discussed in this section. However, much of the following is relevant for the interpretation of article 45 in the LLC Act.

It should be noted that article 45 does not mention the managing company in the list of subjects that are included in the regulation of personal interest. The Commentary on article 45 states that the managing company is included but does not provide any further elaboration.³²⁸ Since the participants'³²⁹ interests are supposed to be protected by this article³³⁰, perhaps the only reason it is excluded is due to a mistake by the legislature. The solution should be regarded as undetermined.

³²⁷ Telyokina, to article 84.

³²⁸ See the commentary to article 45 in Kryrov A A., *Commentaries to the Federal Act on "Companies with Limited Liability"* (Комментарий к Федеральному закону "Об обществах с ограниченной ответственностью"). Moscow, Publishing House "Prospekt", 2006 (Kryrov).

³²⁹ See definition of this term in n 36.

³³⁰ Shitkina, p. 506.

8.3.2 Further regulation on personal interest

Articles 80-84 in the Act on JSC and article 45 in the Act on the LLC regulate “deals” in which the executive has a personal interest. “Deal” is to be understood broadly, and article 81 defines pledging, bail, credit and loans into the term “deal”.³³¹ “Deal” is also defined in article 154 in the Civil Code, stating that “deals” are to be understood as establishing, altering or ceasing civil rights and obligations. Thus, “deals” is to be interpreted widely.

The first sections of articles 81 in the JSC Act and 45 in the LLC define that “personal interest” is present in a deal when the other party, beneficiary party, middleman or representative is a spouse,³³² parent, child, siblings-half-siblings (the LLC article 45 does, however, not include half siblings), adopted child or adopted parents, the executive himself or other “affiliated persons”.³³³ If any of these owns more than 20% in a company, or holds a leading position in a company, they are considered to be associated with the company. “Affiliated persons” is a term used in several instances in Russian legislation. The definition is given in article 4 in the Act on “Competition and Limitation of Monopolistic Business in the Market”,³³⁴ and it defines a number of different positions in companies and stock holding thresholds which make someone “affiliated”. For instance, if a person is holding a position as a higher company official or holding a certain amount of stocks in the company, this person is “affiliated” with the company. The articles of association may provide other caveats that dictate personal interest, pursuant to the last section, article 81 in the JSC Act and the last sentence, first section in article 45 in the LLC Act. The general meeting (GM) may subsequently approve the deal, although this is not directly stated in the Acts.³³⁵

Articles 82 and 83 provide a detailed procedure that is to be presented to the GM or the board of directors (BD) in order for them to approve any deal in which there is a personal interest. Article 45 is not as detailed as the JSC Act when it comes to regulating the mandatory presentation of

³³¹ “Сделки”, “handel”/”avtale”.

³³² “Стороной, выгодоприобретателем, посредником или представителем”. It should be noted that these terms do not reflect a specific and single legal determination. E.g. “middleman” may be understood as “agent” (article 1005 in the Civil Code), commissioner (article 990 in the Civil Code). See further, Shitkina, p. 508.

³³³ ”аффилированные лица”; ”tilknyttede”/”assosierte”.

³³⁴ Federal Act on “Competition and Limitations of Monopolistic Activities in Commercial Markets” of 22 March 1991 (Федеральный закон от 22 марта 1991 N 948-1 “О конкуренции и ограничении монополистической деятельности на товарных рынках”)

The definition that is given in this Act is not particular apt for application in corporate relations, which may prove the provision less effective, according to Shitkina, p. 507.

³³⁵ Shitkina, pp. 513-514, with further references to practice.

information to the GM or the process of approval. If the executive enters into such a deal without following this procedure, he is liable for losses inflicted on the company, pursuant to article 84.

Article 45, section 4 in the LLC Act and article 83, section 5 in the JSC Act provide an exemption for deals that are a part of the company's "normal business operations" and if that type of business operations took place before the executive with a personal interest was recognized as such. Article 83 stipulates the same provision but nuances it by stating that similar deals with similar conditions must have been entered earlier. This also applies to a LLC, according to a court decision,³³⁶ as it states that when proving "normal commercial business", it must be indicated that similar deals have been conducted previously. The Supreme Court (SC) and Supreme Arbitrazhnyi Court (SAC) Resolution, 9 December 1999, N90/14, item 20 mentions that such a transaction may take form as "realization of products; acquisition of raw material; carrying out work, etc.". The exception is only valid until the next session of the GM. The phrase "normal business operations" is similar to that used in article 46 in the LLC Act and article 79 in the JSC Act concerning "major transactions" (cf. section 7.7.5.2).

8.4 Liability when exposing commercial secrets

The "Act on Commercial Secrets" article 11, lists a number of obligations and provisions in order to protect commercial secrets. For instance, it prohibits the disclosure of commercial secrets and using them for personal interest without permission (section 2, subsection 2). Section 6 of the article obliges the manager to secure such secrets and stipulates that the rule is invariable. Section 7 states liability for managers if they violate of the provisions in article 11 with liability vis-à-vis the company. The liability is defined in accordance with the general regulation on civil liability, pursuant to the last sentence of section 7. As the relationship is contractual, article 401 in the Civil Code applies, which provides a fault-based liability. In order to become liable on the basis of article 11, section 7 in the Act on Commercial Secrets, a commercial secret must be revealed in violation of the regulation in the Act, thus constituting a wrongful act. In addition, negligence, causality and losses must be present (see section 6.2). The general rule in civil liability on measurement of losses is provided in article 15 in the Civil Code, which states "full recovery" and applies to damage claims based on article 11 (see section 9).

³³⁶ Cf. FAC Ural District 6 April 2005, N F09-746/05-GK-C5.

Moreover, the scope of articles 71 in the JSC Act and 44 in the LLC would typically encompass situations involving the revelation of commercial secrets, as this is not in the interests of the company, not in good faith and not reasonable. However, this alternative is harder to prove, as the claimant needs to not only prove the violation of The Act on Commercial Secrets, but also how this violates the Duties. This would be, albeit, the only option if a shareholder wants to initiate an indirect claim for damages. This is due to the fact that article 11 does not provide for an indirect lawsuit and only the company may base its claim on article 11.

8.5 Liability regulated by the Act on Securities

The Act on the “Security Market”, heading 5 (articles 19-27) regulates issue of securities and shares. Article 22.1 states liability for the executive together with the company or either one under the process of an issue vis-à-vis the stockholder if a prospect of stocks contains incorrect information. The article states a fault-based liability basis in this instance. Therefore, in order to be liable, the incorrect information, which constitutes the wrongful act, must be committed negligently. Furthermore, the wrongful act must be a proximate cause to the economic loss. “Loss” in this article is worded as “real damage”, which excludes lost profit (see section 9).³³⁷

The time limit for filing the case is 3 years from the date that the issue was released by IPO or from the date that the company addressed the public in an additional issuance of stocks.

³³⁷ “Ущерб” (translated as “damage”/“loss”) is the word the legislation applies when referring only to real damage, not including lost profit. If lost profit is to be included, the term “убытки” is applied (also translated as “damage”/“loss”).

9 Economic damage

9.1 The company's loss

The Acts on JSC and LLC, article 71, section 2 and article 44, section 2 state that the executive is liable for losses he inflicted on the company.³³⁸ Losses are generally defined in the Civil Code article 15, section 2 and apply for all damage claims.³³⁹ More specifically, article 393 in the Civil Code supplements the general article 15 and elaborates the measurement of losses in a claim for damages originated from a contractual relationship.³⁴⁰ The burden of proving the losses is with the responsibility of the claimant.³⁴¹

The economic loss condition may be separated into two questions. The first asks what is to be understood as *economic*, and the second asks how to *measure* the economic loss.³⁴² The limit of the thesis does not allow a thorough examination of these issues, so only the outline is provided here.

It should be noted that in an indirect lawsuit from a shareholder, it is not relevant to consider his losses. As the company is the sufferer, it is only the company's loss that may be claimed. As such, only the company's loss and some general considerations are treated in the following section.

9.2 What is economic damage/loss

In legal literature, "losses" or "loss" is to be understood as "damage, expressed in the form of money".³⁴³ This follows indirectly from the formulations in article 393. The material damage may be recovered in kind, according to the article 393, section 3.³⁴⁴ For instance, if the executive shows negligence in maintaining production equipment, he could restore an affirmed claim for damages in kind. The same applies if the executive has stolen from the company.

³³⁸ In principle, the Civil Code distinguishes between different types of damages, such as "losses" and other forms of damages (moral harm, harm on life and health, commercial reputation etc.).

³³⁹ See e.g. Molotnikov, p. 156.

³⁴⁰ Sadikov, to article 15.

³⁴¹ Abovoy, article 393. Sadikov, article 393.

³⁴² The approach is common in Norwegian law, but the Russian literature does not split up the loss condition in this way. Nevertheless, the distinction is useful for structuring the discussion of the condition.

³⁴³ The quotation refers to same wording in both Molotnikov, p. 156 and Shitkina, p. 474.

³⁴⁴ Resolution SC/SAC, 1 of July 1996 N 6/8, item 49.

When interpreting the term “economic”, it is often difficult to distinguish between an economic loss and other kinds of harm. For example, if a shareholder does not get the chance to vote on the general meeting (GM) due to illegitimate actions by the executive, this does not necessarily lead to an *economic* loss for the shareholder in question. On the same token, a harmed business reputation for the company will not always represent an economic loss, but it may in turn induce economic losses. The assessment of a harmed reputation is relevant in corporate relations, as negative media exposure caused by the executive’s actions may cause harm to the company. When it comes to harming the commercial reputation of the company, an alternative to articles 71 and 44 may be found in article 152 in the Civil Code, which specifically provides a liability basis in cases of intentional public damage to one’s commercial reputation.

9.3 Measuring the size of the loss

Article 15 expresses the principle of “full recovery”. This implies that no enrichment of the claimant is possible. Thus, if there are saved expenses or income advantages for the claimant related to the violation, this must be withdrawn when measuring the size of the claim.³⁴⁵ Article 15, section 1, subsection 2, states that if the defendant generated income as a consequence of the violation, the claimant may claim no less than that which the defendant generated as a result of this consequence.

The “full recovery” rule contains the elements of *real damages* and *lost profit*.

9.3.1 Real damage

Real damages are “expenses” incurred,³⁴⁶ or expenses that will be incurred in the future, which a person has to undertake to restore the violated right or harmed asset, pursuant to article 15. For example, costs of purchasing new production factors in exchange for production factors that have “disappeared” under the supervision of the executive and for which he has become liable. Or, this may appear as costs for restoring assets that are sold from the company at a value that is under the market price.

³⁴⁵ Abovoy, article 393.

³⁴⁶ “Расходы” (“utgift”) is translated not only as “expenses” but comprises “disbursements”, “spending”, “charge”, “burden” and “costs” as well.

Article 393, section 3, elaborates how to measure the restoration costs of an asset in contractual relationships. It states that the expenses are measured in the place where the obligation is to be fulfilled. Presumably, this is the company's physical address.³⁴⁷ Further, the expenses are determined by the costs on the date the obligation should be fulfilled, or if no such date is provided for, the day the lawsuit was filed. At the discretion of the court (guided by the principle of full recovery), the court may also consider the costs at the time of delivering the judgment.³⁴⁸

According to the wording of the article, the claimant has to *restore* the creditor's loss.³⁴⁹ For instance, if the violated right refers to an asset that is sold under market price, it is not the difference between the price for the sold asset and the market price that is claimed but the cost of *restoring the asset*. If the asset is generic, a similar asset may be purchased. If it is a specie type of asset and the original asset cannot be restored, the restoration is accomplished with financial compensation based on the market price of the asset.

When it comes to restoring expenses that will accrue in the future, there is little elaboration. However, Supreme Court (SC) and Supreme Arbitrazhnyi Court (SAC) Resolution, 1 of July 1996 N 6/8, item 10 emphasizes that such claims must be verified thoroughly with evidence and that this may be done in the form of cost estimates for restoring the loss that is caused by the default. Only necessary and reasonable expenses may be affirmed and they must be incurred within reasonable time limits.³⁵⁰

Furthermore, a claim for damages against the executive as a result of a third party's claim against the company will amount to the size of the claim from the third party, in addition to court expenses, in accordance with the "full recovery" rule.

9.3.2 Lost profit

Lost profit is uncollected income, which the sufferer would have gained if his right had not been violated.³⁵¹ According to Sadikov, "losses (...) are also missed income, which the sufferer would

³⁴⁷ This is the author's own presumption.

³⁴⁸ Abovoy, article 393.

³⁴⁹ "возместить кредитору убытки"

³⁵⁰ Sadikov, article 15.

³⁵¹ See eg Black, et al, p. 90.

have gained under normal conditions for daily business operations if it had not been for the infringement”,³⁵² pursuant to article 15, section 2, subsection 1. According to SC/SAC Resolution, 1 of July 1996 N 6/8, item 11, when assessing the income based on “normal conditions for daily business operations”, this must take into account an estimate of reasonable expenditures that the claimant would have if the obligations were rightfully fulfilled. For example, if the executive sells a production factor under the market price, the lost profit is estimated as the net profit that would have been generated if this production factor had not been sold.³⁵³

9.4 Assessing losses with regard to articles 71 and 44, sections 3

Article 71, section 3 in the JSC Act and article 44, section 3 in the LLC Act allow for business custom and other circumstances to be taken into account (cf. section 7.5) when assessing the size of liability. This implies taking into consideration the degree of negligence/intention or the “bad faith” of the defendant when assessing the size of the recovery. This opens possible mitigation of the recovery under certain circumstances, such as when the losses were caused unintentionally and his actions could be considered somewhat excusable.³⁵⁴ Nonetheless, this provision is not elaborated upon in Russian law. Consequently, as stated by Ivanov, it remains to be worked out in practice.³⁵⁵ Osipenko concludes that the courts are reluctant to give a clear conception of this provision.³⁵⁶

Exceptions from the “full recovery” rule may arise when there are circumstances that influenced the loss that were under the company’s own responsibilities. This might be interpreted in Article 71, section 3 in the JSC Act and article 44, section 3 in the LLC Act. For example, if the board of directors (BD) did nothing to fulfill their duty to mitigate losses that originated from the wrongful action of the executive. In this situation it is arguable that the executive should not sustain the full recovery. This exception is not as clearly provided for in Russian law as it is in Norwegian law. Under Norwegian law, there is a general duty for the sufferer to mitigate his losses.

³⁵² ”Под убытками понимаются расходы (...), а также неполученные доходы, которые это лицо получило бы при обычных условиях гражданского оборота, если бы его право не было нарушено (упущенная выгода).”; “обычных условиях гражданского оборота” (“alminnelige borgerlige omsetningsvilkår”) is literally translated “normal conditions for civil turnover”. For grasping the legal concept more accurately, a more precise translation would be “regular course of business” or “normal conditions for daily business operations”.

³⁵³ Similar example in Shitkina, p.475.

³⁵⁴ Ivanov 1998 p. 97.

³⁵⁵ L.c.

³⁵⁶ Osipenko, p. 478.

10 Causality

The condition of causality is generally recognized as a condition for civil liability.³⁵⁷ In contracts, this may be derived from article 393, section 1 in the Civil Code, stating that the debtor shall restore losses to the creditor that are *caused* by his non-fulfillment of obligations.³⁵⁸ The condition also ensues from an interpretation of the phrase “losses caused to the company” in section 2 of articles 71 and 44 in the Acts on JSC and LLC.³⁵⁹

The wrongful act must be the objective reason for the loss and it “must cause the same loss in every similar situation, and should not be caused by any coincidences”,³⁶⁰ as Syxanov states. And further, he emphasizes that it is not enough that the harmful action or inaction is a condition for the loss, but the reason for it must always lead to the same result. Seemingly, he then asserts that it must be an absolute cause-and-effect relationship.³⁶¹

There are a few court decisions that elaborate the nuances of what it takes to prove causality. Practice, however, shows that there are difficulties in establishing a cause-and effect relationship between a manager’s actions and subsequent losses.³⁶²

Nevertheless, some fundamental conditions may be derived. First, the breach of the obligation must precede the losses.³⁶³ Second, the breach of the obligation must be a necessary and sufficient prerequisite for the entry of the loss.³⁶⁴ It should be noted that to prove causality, one must demonstrate written evidence in order to get the court’s support since Russian courts emphasize written evidence.³⁶⁵ Taking into these conditions into consideration, the threshold to uphold a claim presents serious difficulties if the cause is not obvious.

³⁵⁷ Unfortunately, the literature and court rulings the author succeeded to find on this matter were rather poor.

³⁵⁸ ”Должник обязан возместить кредитору убытки, причиненные неисполнением или ненадлежащим исполнением обязательства.”

³⁵⁹ ”убытки, причиненные обществу”.

³⁶⁰ Sukhanov, p. 605.

³⁶¹ Under Norwegian law, the assessment under this condition may, to a certain extent, be dependent on the grossness of the defendant’s action.

³⁶² Black, et al, p. 240; See definition in n 10 for the term “manager”.

³⁶³ SAC Resolution, 2 April 1996, N7465/95.

³⁶⁴ SAC Resolution, 20 May 1997, N4931/96.

³⁶⁵ Efeev p. 7.

Furthermore, even if the cause is exclusive and traceable, the loss has to be a foreseeable consequence of the wrongful act. This rule is provided for in most Western legislation. Under Norwegian liability law, this is known as the adequate-rule,³⁶⁶ and in Anglo-American law, this is often referred to as “proximate cause”. Under Russian law, Molotnikov and Sjitkina underscore that in a claim for damages originated from corporate relations, the cause must be adequate to the loss in order to claim it restored.³⁶⁷ Unfortunately, they do not elaborate on this any further. Efeev asserts that in Russian legal theory and practice, the causality condition and principle of proximate cause have been neglected and regarded as not presenting any difficulties in practice and that these conditions are more suitable for a theoretical examination than a practical one.³⁶⁸ He underscores that it has not taken a firm stand on these questions as a matter of Russian liability law, but concludes that when assessing the causality condition, this should be guided by the adequate principle.³⁶⁹ Moreover, he concludes that modern Russian legal literature is inclined to recognize the adequacy principle, without substantiating this further. Efeev points out that the adequate principle does not restrain the court’s discretion, but gives it flexibility to consider if it would be reasonable to award the losses in question. This is especially true with regard to liability cases against executives, as it often will be difficult to prove lost profit. For instance, if the executive hampers the conducting of the general meeting (GM) and this lead to losses by preventing the affirmation of a favorable deal, this conduct is a proximate cause to the loss. However, if the delay of conducting the GM leads to a lost opportunity for entering into an unforeseen, yet favorable deal, then it is unlikely that the loss would be appraised as proximate. In cases where the executive exceeds his competence, the adequate causality is more easily proven. This is due to the fact that the exceeding one’s competence is usually committed in relation to the conclusion of concrete deals, in which losses can more easily be identified and can have more foreseeable consequences (e.g. the under-market price at which an asset was sold, compared with the marked price). However, the challenge is still to prove the proximate cause between the lost profit and the wrongful act. The burden of proving this is presumably heavy for the claimant.

³⁶⁶ “Adekvansvilkåret i erstatningsretten”.

³⁶⁷ Shitkina, p. 475; Molotnikov, p. 157.

³⁶⁸ Efeev, p. 3.

³⁶⁹ “Принцип адекватности”; He refers to court practice where different approaches have been applied, but, in Efeev’s opinion, not giving any meaningful guidelines.

In conclusion, the lack of relevant literature and relevant cases makes it difficult to provide more elaborate and meaningful guidelines on the proximate cause condition. This notion applies to the economic damage condition, as well. Hence, in a claim for damages, it is likely that the outcome will depend more on the persuasiveness of the evidence than on nuanced legal argumentation.

11 List of literature

English titles and translation of titles is written in italics. Non-English original titles are provided in brackets. The systems for Romanizing Russian letters in this thesis is BGN/PCGN. References to “G” means that the contribution is provided in Garant legal database.³⁷⁰

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11.2 Other resources

Supreme Court’s homepage <www.supcourt.ru/eng>

Supreme Arbitrazjniy Court’s homepage <www.arbitr.ru/eng>

Legal database Garant (see www.garant.ru for information)

Legal database Konsultant plus (see www.consultant.ru for information)

12 List of acts

Russian acts

Federal Act on “Commercial Secrets” of 29 June 2004 (Федеральный закон от 29 июля 2004 N 98-ФЗ ”О коммерческой тайне”)

“The Civil Procedural Code” of 14.11.2002 (Гражданский процессуальный кодекс РФ от 14 ноября 2002 N 138-ФЗ)

“The Arbitrazhnyi Procedural Code” of 24.07.2002 (Арбитражный процессуальный кодекс Российской Федерации от 24 июля 2002 N 95-ФЗ)

“The Labor Code” of 30.12.2001 (Трудовой кодекс Российской Федерации от 30 декабря 2001 N 197-ФЗ)

Federal Act on “Companies with Limited Liability” of 8 February 1998 (Федеральный закон от 8 февраля 1998 г. N 14-ФЗ ”Об обществах с ограниченной ответственностью”)

Federal Act on “Enforcement Proceedings” of 21 June 1997 (Федеральный закон от 21 июля 1997 г. N 119-ФЗ ”Об исполнительном производстве”)

Federal Act on “Bookkeeping” of 21 November 1996 (Федеральный закон от 21 ноября 1996 г. N 129-ФЗ “О бухгалтерском учете”)

Federal Act on “Security Market” of 22 April 1996 (Федеральный закон от 22 апреля 1996 г. N 39-ФЗ “О рынке ценных бумаг”)

Federal Act on “Joint Stock Companies” of 26 December 1995 (Федеральный закон от 26 декабря 1995 г. N 208-ФЗ “Об акционерных обществах”)

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Federal Act on “Competition and Limitations of Monopolistic Activities in Commercial Markets” of 22 March 1991 (Федеральный закон от 22 марта 1991 N 948-1 “О конкуренции и ограничении монополистической деятельности на товарных рынках”)

Norwegian acts

”Lov om aksjeselskaper” (Act on LLC) of 13/06, 1999 nr 44

“Lov om allmennaksjeselskaper” (Act on JSC) of 13/05, 1999 nr 45.

”Lov om kjøp” (The Sale of Goods Act) of 13/5, 1985 nr 27.

“Lov om opphavsrett til åndsverk m.v.” (Act on Intellectual Property) of 5/12, 1961 nr 2.

13 List of judicial practice

Resolution Supreme Court (SC) and Supreme Arbitrazhnyi Court (SAC) 9 December 1999, N 90/14

Resolution SC/SAC 1 July 1996, N6/8

Resolution SAC 22 May 2007, N871/07

Resolution SAC 18 November 2003, N19

Resolution SAC 16 May 2000, N2193/98

Resolution SAC 20 May 1997, N4931/96

Resolution SAC, 2 April 1996, N7465/95

Information Letter SAC, 30 May 2005, N92.

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